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U.S. Dept. of the Treasury.

PRESS

RELEASES.

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JANUARY 4, 1977

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FEBRUARY 28, 1977

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

FOR IMMEDIATE RELEASE
WEDNESDAY, JANUARY 5, 1977
CONTACT: PRISCILLA CRANE (202) 634-5248

THIRD QUARTER ANTIRECESSION FUNDS PAID TODAY

The third quarterly payment of antirecession funds authorized to be distributed to States and local units of general government under Title II of the Public Works Employment Act of 1976 (P.L. 94-369) is being made today by the Department of the Treasury's Office of Revenue Sharing.

A total of $310,937,539 was allocated to eligible recipient governments for the third quarter. Because some governments also are being paid their first and second quarter amounts this month, however, the Office of Revenue Sharing is issuing payments totaling $328,593,465 to 17,145 units of State and local general government today. Approximately $1.8 million in first, second and third quarter funds is still being held for 808 eligible recipients which have yet to return to the Office of Revenue Sharing certain assurance forms which are required by the antirecession law.

Today's payment brings to $868,752,794 the total distributed thus far under the new program. A total of $870,625,060 has been allocated to eligible recipients for the first three quarters, including the $1.8 million being held for eligible recipients mentioned above.

In addition, the Office of Revenue Sharing is holding $5.1 million in a reserve fund which will be used to make required adjustment payments in the future. Reserve funds not required for such adjustments will be distributed to eligible governments at a future time.

Antirecession law authorizes the distribution of $1.25 billion in five calendar quarters, beginning July 1, 1976. "No funds will be distributed for a quarter if the applicable national unemployment rates fall below six percent or if the funds authorized by Congress for the program have been exhausted in prior quarters," Jeanna D. Tully, Director of the Office of Revenue Sharing, announced today.

Allocations of funds to individual units of government are based on applicable unemployment rates and on final entitlement amounts for Federal fiscal year 1976 in the General Revenue Sharing Program.

The money is to be used to maintain ongoing, basic services in recipient communities.

"The next quarterly payment of antirecession funds will be made in April 1977," according to Miss Tully. "Governments which return their required assurance forms by March 11, 1977 will receive all money to which they are entitled for the first four quarters of the program in the April payment," she added.

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

FOR IMMEDIATE RELEASE December 30, 1976

The Acting Secretary of the Treasury issued today additional guidelines relating to certain provisions of the Tax Reform Act of 1976 which deny certain tax benefits for participation in or cooperation with international boycotts. An earlier set of guidelines, consisting of questions and answers, was issued on November 4, 1976 (Treasury News Release WS-1156) and was published in the Federal Register of November 11, 1976 (41 F.R. 49923). These guidelines relate only to parts A through G of the earlier guidelines and add a new part N, relating to the computation of the foreign tax credit. These guidelines do not deal with those provisions of the Tax Reform Act of 1976 which define what constitutes participation in or cooperation with an international boycott. Some of the guidelines issued today are new while others are revisions of earlier questions and answers. The same numbering system is used, and the same introductory material is applicable.

This announcement and the guidelines will appear in the Federal Register of January 5, 1977.

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WS-1239

A. Boycott Reports.

A-1. Q: Who must report as required by section 999(a)?

A. Generally, any United States person (within the meaning of section 7701(a)(30)), or any other person (within the meaning of section 7701(a)(1)) that either claims the benefit of the foreign tax credit under section 901, or owns stock of a DISC, is required to report under section 999(a) if it --

1. has operations; or

2. is a member of a controlled group, a member of which has operations; or

3. is a United States shareholder (within the meaning of section 951(b)) of a foreign corporation that has operations; or

4. is a partner in a partnership that has operations; or

5. is treated under section 671 as the owner of a trust that has operations

in or related to a boycotting country (or with the government, a company, or a national of a boycotting country). Additionally, if a person controls a corporation (within the meaning of section 304(c)) and either that person or the controlled corporation is required to report under section 999(a), then under section 999(e) that person must report whether the corporation had reportable operations and whether the corporation participated in or cooperated with the boycott. The controlled corporation must make the same reports with respect to the operations of the person controlling it.

A boycotting country is

(i) any country that is on the list maintained by the Secretary under section 999(a)(3), or

(ii) any country not on the list maintained by the Secretary under section 999(a)(3), in which the person required to file the report (or a member of the controlled group which includes that person) has operations, and which that person knows or has reason to know requires <u>any person</u> to participate in or cooperate with an international boycott that is not excepted by section 999(b)(4)(A), (B), or (C). Thus, even if the boycott participation required of the person reporting the operation is excepted by section

999(b)(4)(A), (B), or (C), if that person knows or has reason to know that boycott participation not excepted by section 999(b)(4)(A), (B), or (C) is required of any other person, the country is a boycotting country.

If the person required to file the report (or a member of the controlled group which includes that person) has operations related to a country, but not operations in that country, that country is not a boycotting country unless it is on the list maintained by the Secretary under section 999(a)(3). (For the definition of operations in or related to a country, see the questions and answers under part B.)

A-11. Q: If Company A sells goods or services to Company B (or does other business with Company B) and Company B and Company A are unrelated, and Company A knows or has reason to know that Company B in turn will sell these goods or services for use in a boycotting country, and further, Company B participates in or cooperates with such boycott, is Company A required to report with respect to such operations?

A: Although such operations are related to a boycotting country (see the answer to Question B-1), the reporting requirements are waived for Company A, provided that Company A does not receive a request to participate in or cooperate with an international boycott under section 999(a)(2), Company A does not participate in or cooperate with an international boycott under section 999(b)(3), and Company A's relationship with Company B is not established to facilitate participation in or cooperation with an international boycott.

A-13. Q: In the case of a controlled group, what period of time is the international boycott report to cover, and when is the "International Boycott Report Form," Form 5713, to be filed?

A: For purposes of reporting, all persons described in the answer to Question A-1 are to report all reportable operations by all members of the controlled group (or by any foreign corporation with a United States shareholder who is a member of the controlled group) for the taxable years of such members which end with or within the taxable year of the controlled group's common parent. The international boycott factor is computed on the basis of the operations of all members of the controlled group for the taxable years of such members which end with or within the taxable year of the controlled group's common parent. In the event no common parent exists, the members of the controlled group are to elect the tax year of one of the members to serve as the common tax year for the group. It is contemplated that procedures for making an election will be specified in the instructions of the "International Boycott Report Form," Form 5713. The taxable year election is a binding election to be made once, with subsequent elections for alternative tax years granted only with the approval of the Secretary of the Treasury or his delegate.

Individual members of the controlled group will continue to use their normal tax years for all other purposes, including adjustments required under sections 908, 952(a), and 995(b)(1). When the international boycott factor is used, the controlled group boycott factor, for that year, will be applied to the normal tax year of each taxpayer for determining adjustments under sections 908, 952(a) and 995(b)(1).

The income tax year of a taxpayer may differ from the reporting period covered by the "International Boycott Report Form." Therefore, the Form 5713 which is attached to, and filed with, the income tax return of the taxpayer will be the Form 5713 for the reporting year ending with or within the tax year of the taxpayer.

A-14. Q: Is a United States subsidiary of a foreign corporation or a United States sister corporation of a foreign corporation required under section 999 to report the operations of the foreign parent or sister corporation?

A: Generally, under section 999 a United States person must report the operations of all members of the controlled group of which it is a member. However, if the foreign parent or sister corporation is not otherwise required to report, the requirement that the United States subsidiary or sister corporation report the operations of the foreign parent or sister corporation will be waived for any United States subsidiary or sister corporation which--

1. is entitled to no benefits of deferral, DISC, or the foreign tax credit, or

2. applies the international boycott factor, and forfeits all the benefits of deferral, DISC and the foreign tax credit to which it is entitled (i.e., applies an international boycott factor of one under sections 908(a), 952(a)(3), and 995(b)(1)), or

3. identifies specifically attributable taxes and income, and forfeits all the benefits of deferral, DISC, and the foreign tax credit in respect of which it is unable to demonstrate that the foreign taxes paid and the income earned are attributable to specific operations in which there was no participation in or cooperation with an international boycott.

A-15. Q: Company A receives from Country X an unsolicited invitation to tender for a contract for the construction of an industrial plant in Country X. The tender documents contain a provision stating that Country X will not enter into the contract unless the successful tenderer agrees that it will do no business in connection with the project with any blacklisted United States company. Company A does not respond to the unsolicited invitation. Is Company A required to report the invitation under section 999(a)(2) as a request to participate in or cooperate with an international boycott?

A: No. The section 999(a)(2) reporting requirement will be waived provided that Company A neither solicited the invitation to tender nor responded to the invitation.

A-16. Q: Company A receives requests to comply with boycotts prior to the issuance of Form 5713. Company A preserves the requests which were evidenced in writing and preserves the notations it makes concerning the details of oral requests. When Form 5713 is issued, it requires more details concerning the requests made of Company A than were preserved, and many of those details can no longer be ascertained. Will Company A's report under section 999(a)(2) be deemed deficient?

A: On October 4, 1976, Company A was put on notice that it would be required to document boycott requests received after November 3, 1977. Form 5713 will not require any details that would not have been preserved by a prudent person having such notice. In addition, under the answer to Question A-15, the reporting requirements of section 999(a)(2) have been waived for certain unsolicited boycott requests. Therefore, if Company A does not supply the required information with respect to the remaining requests that were either solicited or responded to, its report will be deficient.

A-17. Q: A United States partnership consisting of 100 United States partners has operations in a boycotting country. Is each partner required to file Form 5713?

A: Generally, if a partnership has operations in a boycotting country, each partner is required to file Form 5713. However, if the partnership files Form 5713 with its information return and has no operations for the taxable year that constitute participation in or cooperation with an international boycott, then the requirement that each partner file Form 5713 will be waived for each partner that satisfies the following conditions:

1. The partner has no operations in or related to a boycotting country, or with the government, a company, or a national of a boycotting country other than operations that are reported on the Form 5713 filed by the partnership; and

2. The partner attaches to his individual return a certificate signed by a person authorized to sign

the partnership return certifying that the partnership filed the Form 5713 and that the partnership had no operations that constituted participation in or cooperation with an international boycott.

A-18. Q: Company A owns 10 percent or more of the outstanding stock of Company C, a foreign corporation that has operations in Country X, but Company A does not have effective control over Company C. Company C participates in or cooperates with an international boycott. Company A requests information from Company C in order to meet its reporting obligations under section 999(a). Company C refuses to provide (or is prohibited by local law, regulation, or practice from providing) that information. Will Company A be subject to the section 999(f) penalties for willful failure to report the activities of Company C?

A: Company A must report on the basis of that information that is reasonably available to it. For example, in most cases Company A will be aware that Company C has operations in Country X, even though Company A is not aware of the operational details. Company A must report on Form 5713 that Company C has operations in Country X. Company A should also describe in a statement attached to Form 5713 the good faith efforts that it has made to obtain all the information required under section 999(a). Although each case must be resolved on the basis of the particular facts and circumstances, Company A will not be subject to the section 999(f) penalties for willful failure to provide information if it can demonstrate that it made good faith efforts to obtain the information but was denied the information by Company C. The answer to this question would be the same if Company C were a domestic corporation.

A-19. Q: The facts are the same as in A-18 above except that Company A owns less than 50 percent of the stock of Company C. What are the tax sanctions to which Company A will be subject?

A: Since Company C is neither a DISC nor a controlled foreign corporation, the sanctions of section 952(a)(3) and 995(b)(1) are not relevant. However, Company A will be subject to the sanctions of section 908(a). Thus, if Company A applies an international boycott factor, that factor is applied to Company A's foreign tax credit in accordance with the answers to Questions F-5, N-1 and N-2. If Company A identifies specifically attributable taxes and income under section 999(c)(2), Company A will lose its section 902 indirect foreign tax credit for the taxes paid by Company C which Company A cannot demonstrate are attributable to specific operations in which there was no boycott participation or cooperation. (To determine whether Company A will lose its section 901 direct foreign credit for income tax withheld by Country X on dividends paid by Company C to Company A, see the answer to Question N-3.)

A-20. Q: Individual G is a national of Country X, which is on the list maintained by the Secretary. G engages in an operation with Company A. For example, if Company A were a bank, the operation might involve a deposit by G, or, if Company A were an automobile dealer, the operation might involve the purchase of a car, or, if Company A were a stockbroker, the operation might involve the purchase or sale of a security, or if Company A were a hotel, the operation might involve the letting of a room. Irrespective of the specific nature of the operation, the agreement under which the operation is consummated is the same agreement which Company A requires of all other customers. Company A is aware of G's nationality, but participation in or cooperation with an international boycott is neither contemplated nor required as a condition of G's willingness to enter into the operation with Company A. Under section 999, what are the reporting obligations of Company A with respect to these operations?

A: Company A is not obligated to report these operations with G under section 999(a). In many business operations, there will be incidental contacts between the nationals or business enterprises of boycotting countries and U.S. persons or businesses in which they have an interest. Such contacts need not be reported under section 999 provided that they satisfy the following criteria:

1. The nationality of the individual or enterprise is merely incidental to the operations,

2. the location of an operation contemplated by the parties is outside any boycotting country,

3. any goods or services to be furnished or obtained in the operation are not produced in a boycotting country and are not intended to be used, consumed, disposed of or performed in a boycotting country,

4. the operation does not contemplate any agreement which would constitute participation in or cooperation with an international boycott,

5. no request for such an agreement is actually made or received by any party to the operation, and

6. there is no such agreement in connection with the operation.

The types of operations described above satisfy these criteria and accordingly need not be reported under section 999. The answer to the question would be the same if Company A were an individual, or if G were a corporation.

B. Definition of "Operations"

B-2. Q: Individual G is a U.S. citizen living in Country X. G is retired. G receives social security payments and a pension, but has no business activities. Does G have "operations" in, or related to, Country X?

A. No. G is not engaged in any business or commercial activities.

B-3. Q: Individual H is a U.S. citizen living in Country X and working there as an employee. H earns a salary and has passive investment income, but has no business income. Does H have "operations" in, or related to, Country X?

A: No. The performance of personal services as an employee does not constitute an "operation."

E. Effective Date Provisions

E-9. Q: Company A entered into a binding contract prior to September 2, 1976 to manufacture and deliver equipment to a customer located in Country X. The contract requires Company A to use no components which are manufactured by blacklisted United States companies. The contract also requires that the vessel on which the equipment is shipped not be blacklisted. On January 15, 1977, Company A is able to have the contract amended to eliminate the requirement regarding components, but is unable to secure any change regarding vessels. Will the amendment regarding components remove the binding contract protection otherwise afforded until December 31, 1977 that Company A has regarding vessels?

A: No. Since Company A could have waited to abrogate or renegotiate its contract until the end of 1977 and since it is in accord with the legislative purpose for Company A to accelerate elimination of the provision regarding components, it will remain protected until December 31, 1977 from the consequences of its continuing to refrain from shipping the goods on blacklisted vessels.

E-10. Q: If before December 31, 1977 a person carries out several different operations in boycotting countries and the only operation of that person that constitutes participation in or cooperation with an international boycott is carried out in accordance with the terms of a binding contract entered into before September 2, 1976, will the existence of that one boycotting operation trigger the section 999(b)(1) presumption that the other operations of that person in boycotting countries are also operations in connection with which boycott participation or cooperation occurred?

A: No. Operations carried out before December 31, 1977, in accordance with the terms of a binding contract entered into before September 2, 1976, will not trigger the section 999(b)(1) presumption.

E-11. Q: Are operations of a person that constitute participation in or cooperation with an international boycott reflected in the numerator of the person's international boycott factor before December 31, 1977 if those operations are carried out in accordance with the terms of a binding contract entered into before September 2, 1976?

A: No. Boycotting operations carried out before December 31, 1977 in accordance with the terms of a binding contract entered into before September 2, 1976 are not reflected in the numerator of the international boycott factor. They are reflected in the denominator, however.

F. International Boycott Factor and Specifically Attributable Taxes and Income.

F-5. Q: In the case of a controlled group (within the meaning of section 993(a)(3)), may one member use the international boycott factor under section 999(c)(1) and another member identify specifically attributable taxes and income under section 999(c)(2)?

A: Yes. Each member may independently choose either to apply the international boycott factor under section 999(c)(1) or to identify specifically attributable taxes and income under section 999(c)(2). The method chosen by each member for determining the loss of tax benefits must be applied consistently to determine all loss of tax benefits of that member. For example, if a member chooses to use the international boycott factor, then it must apply the international boycott factor to determine its loss of the section 902 indirect foreign tax credit in respect of a dividend paid to it by another member of the controlled group, even if that other member determines its loss of tax benefits by identifying specifically attributable taxes and income. In addition, if an affiliated group of corporations files a consolidated return, then the affiliated group must determine its loss of tax benefits either by applying the international boycott factor to the consolidated return, or by having each member determine its loss of tax benefits by identifying specifically attributable taxes and income.

F-6. Q: If Company A chooses to determine its loss of tax benefits by applying the specifically attributable taxes and income method set forth in section 999(c)(2), may it demonstrate the amount of foreign taxes paid and income earned attributable to the specific operations by applying an overall effective rate of foreign taxes and an overall profit margin to each operation?

A: No. Company A must clearly demonstrate foreign taxes paid and income earned attributable to specific operations by performing an in-depth analysis of the profit and loss data of each separate and identifiable operation.

F-7. Q: A United States partnership has operations in a boycotting country. Is the international boycott factor computed at the partnership level?

A: No. The international boycott factor is computed separately by each partner based on information submitted by the partnership and on other activities of that partner. Of course, if the partner can meet the conditions of section 999(c)(2) of the Code, he need not use the international boycott factor.

F-8. Q: Company A desires to determine its loss of tax benefits by applying the specifically attributable taxes and income method set forth in section 999(c)(2). However, Company A is able to identify specifically attributable taxes and income only with respect to a portion of its operations. Because Company A is unable to determine specifically attributable taxes and income with respect to all its operations, will Company A be required to determine its loss of tax benefits by applying the international boycott factor?

A: No. Company A may compute its loss of tax benefits by applying the specifically attributable taxes and income method if, in addition to the tax benefits that Company A determines are to be lost with respect to the portion of its operations for which it can determine specifically attributable taxes and income, Company A forfeits all the benefits of deferral, DISC, and the foreign tax credit with respect to the remaining portion of its operations for which it cannot identify specifically attributable taxes and income.

N. Reduction of Foreign Tax Credit

N-1. Q: How is the reduction of the foreign tax credit for participation in or cooperation with an international boycott computed under section 908?

A: The method of computation of the reduction of the foreign tax credit under section 908 differs depending on whether the person applying section 908 applies the international boycott factor or identifies specifically attributable taxes and income under section 999(c)(2).

If the person chooses to identify specifically attributable taxes and income, the person reduces the amount of foreign taxes paid before the determination of the section 904 limitation, by the sum of the foreign taxes paid that the person has not clearly demonstrated are attributable to specific operations in which there has been no participation in or cooperation with an international boycott.

If the person applies the international boycott factor, the reduction of the foreign tax credit under section 908 is computed by first determining the foreign tax credit that would be allowed under section 901 for the taxable year if section 908 had not been enacted. The amount of credit allowed under 901 would, of course, reflect the credits allowable under sections 902 and 960, and would also reflect the limitations of both sections 904 and 907. The credit allowed under section 901 would then be reduced by the product of the section 901 credit (before the application of the section 908 reduction) multiplied by the international boycott factor.

N-2. Q: After the reduction of credit has been determined in accordance with the process described in the answer to Question N-1, the taxes denied creditability may be deductible. If the taxes are deducted, is a new section 904 limitation, a new section 901 amount and a new section 908 reduction of credit computed based on the income reduced by the taxes deducted?

A: No. The process described in the answer to Question N-1 is applied only once and the reduction of credit is determined as a result of that single application. If the taxes denied creditability are deducted, no further adjustment is made under sections 904, 901 or 908 as a result of the deduction.

N-3. Q: Company A owns 20 percent of the stock of Company C, a corporation organized under the laws of Country X. Company C participates in an international boycott in connection with all its operations. Company C pays a dividend to Company A and Country X withholds income tax on the dividend paid to Company A. Company A computes its loss of tax benefits by identifying specifically attributable taxes and income under section 999(c)(2). Will Company A be denied its section 901 direct foreign tax credit in respect of the income tax withheld by Country X on the dividend paid by Company C?

A: If Company A can demonstrate that its investment in Company C is a clearly separate and identifiable operation in which Company A did not participate in or cooperate with an international boycott, Company A will not be denied its section 901 direct foreign tax credit in respect of the withholding tax on the dividend paid by Company C. On the other hand, even if Company C does not participate in an international boycott, if Company A agreed to participate in or cooperate with an international boycott in connection with its investment in Company C, Company A will lose its foreign tax credit in respect of the withholding tax on the dividend. Thus, whether Company C participates in an international boycott is not relevant to the determination of Company A's loss of foreign tax credit under the facts of this question. (To determine the denial of the section 902 indirect foreign tax credit for foreign income taxes paid by Company C, see the answer to Question A-19.)

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

FOR IMMEDIATE RELEASE January 3, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,501 million of 13-week Treasury bills and for $3,500 million of 26-week Treasury bills, both series to be issued on January 6, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 7, 1977			26-week bills maturing July 7, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.896 a/	4.367%	4.48%	97.711	4.528%	4.70%
Low	98.881	4.427%	4.54%	97.691	4.567%	4.74%
Average	98.886	4.407%	4.52%	97.697	4.555%	4.73%

a/ Excepting 2 tenders totaling $410,000

Tenders at the low price for the 13-week bills were allotted 24%.
Tenders at the low price for the 26-week bills were allotted 15%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 25,985,000	$ 24,985,000	$ 41,655,000	$ 39,655,000
New York	3,531,850,000	2,075,850,000	4,452,865,000	3,104,865,000
Philadelphia	22,690,000	22,690,000	10,070,000	10,070,000
Cleveland	22,820,000	22,820,000	9,290,000	9,290,000
Richmond	12,645,000	12,645,000	16,720,000	6,295,000
Atlanta	23,405,000	23,405,000	13,855,000	13,855,000
Chicago	239,925,000	148,525,000	416,640,000	128,840,000
St. Louis	49,830,000	41,830,000	32,160,000	17,160,000
Minneapolis	24,750,000	24,750,000	38,900,000	33,900,000
Kansas City	24,325,000	24,325,000	15,165,000	14,665,000
Dallas	22,215,000	22,215,000	28,085,000	24,385,000
San Francisco	214,310,000	56,710,000	330,745,000	97,245,000
Treasury	35,000	35,000	30,000	30,000
TOTALS	$4,214,785,000	$2,500,785,000 b/	$5,406,180,000	$3,500,255,000

b/Includes $284,620,000 noncompetitive tenders from the public.
c/Includes $118,800,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

WS-1240

The Department of the TREASURY NEWS
OFFICE OF REVENUE SHARING
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FOR IMMEDIATE RELEASE
FRIDAY, JANUARY 7, 1977
CONTACT: PRISCILLA CRANE (202) 634-5248

REVENUE SHARING PAYMENT MADE

The final payment of general revenue sharing funds authorized when revenue sharing law first was passed in 1972 is being made today to 37,405 States and units of local general government. The amount being distributed today by the Department of the Treasury's Office of Revenue Sharing is $1,644,877,971.

"Today's payment brings to $30 billion the total which has been returned to States and local governments through general revenue sharing since the program began," Jeanna D. Tully, Director of the Office of Revenue Sharing, announced today.

The first quarterly payment of funds authorized by the 1976 Amendments to revenue sharing law which extended the program for an additional three and three-quarters years will be made in April 1977.

Of the more than 37,000 governments being paid today, 24,384 will receive their money using electronic funds transfer procedures. "This new procedure will save time and administrative expense," according to Miss Tully.

Approximately 600 units of local government which

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had been entitled to participate in the revenue sharing program for the July 1, 1976-December 31, 1976 period did not receive their funds. These units of government failed to file one or both of two short report forms, required by revenue sharing law, which were due to be returned to the Office of Revenue Sharing before September 1, 1976.

The more than $2 million which would have been paid to these governments, will be paid, instead, to the next higher level of government within each affected State.

On October 13, 1976, President Ford signed into law a measure which will extend the General Revenue Sharing Program through September 30, 1980. A total of $25.6 billion is authorized to be returned to approximately 38,000 State and local government recipients under the renewal legislation.

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Call: Brian M. Freeman
376-0321

FOR IMMEDIATE RELEASE January 4, 1977

EMERGENCY LOAN GUARANTEE BOARD SENDS ANNUAL REPORT TO CONGRESS

On December 30, 1976, the Emergency Loan Guarantee Board delivered its Fifth Annual Report to Congress describing its operations from August 1, 1975, to September 30, 1976. In the Board's opinion, Lockheed Aircraft Corporation's financial position has improved and certain uncertainties have been eliminated. Although risks exist, the Company's latest forecast is reasonable. The major hazard to Lockheed's continued viability is the future of the L-1011 program; but further disclosures of improper foreign-payments practices could prove troublesome, and new capital remains necessary. If Lockheed meets its projections, the Government will not be called upon to make payment on the private bank debt which it guarantees. If, however, it should be thus called upon, its position is adaquately protected by its first lien on the collateral which secures the guaranteed debt. There is a "reasonable probability" that the guarantee commitment will terminate as scheduled in December 1977 and a "strong possibility" of its earlier termination if certain uncertainties are favorably resolved in a timely manner. However, the parties can also request that the Board exercise its discretion to grant a final one-year extension through 1978.

Lockeed repaid $55 million of guaranteed debt through the third quarter of 1976, which reduced the amount outstanding to $140 million. Repayments through December 30 reduced it to $100 million. Peak borrowings were $245 million in September 1974.

The ELGB program's net earnings for the period were $8 million, bringing the cumulative amount to $25 million since 1971.

The report emphasizes Lockheed's October 1976 financial restructuring by which $50 million of nonguaranteed bank debt was converted to preferred stock and the remaining $350 million of such debt to a term loan, and by which the lending banks were issued an additional 1.75 million of warrants for Lockheed common stock. Lockheed remains obligated to seek additional long-term capital.

The Emergency Loan Guarantee Board looked into Lockheed's payments to foreign officials and the subsequent investigation by governmental agencies. The report emphasizes the Board's monitoring activities; the requirements it imposed upon Lockheed; its input on Lockheed's international marketing policy; and amendments to the underlying agreements which make certain payments and violations of corporate policy events of default. It also discusses the Board's assessment that, based upon the information in its possession, Lockheed could survive the effects of disclosure of past foreign-payment practices and satisfy its repayment obligations for the guaranteed debt.

WS-1242

Part II of the report focuses on Lockheed's operations. It describes the Company's management changes and the continued profitability of its noncommercial operations and unprofitability of the L-1011 commercial program. The Company's foreign export sales have continued to improve despite disruptions from disclosures of foreign-payment practices.

Lockheed's year-end 1975 cash lagged behind projections due to undelivered aircraft and unanticipated buildups in inventories and accounts receivable. However, the inventoried aircraft were delivered in 1976, permitting repayments of guaranteed debt beginning in the second quarter of 1976. The report emphasizes that 1976 paydowns exceeded forecasts and that all guaranteed borrowings are forecast to be repaid at the end of the guarantee period in 1978.

The L-1011 program is considered in depth, including marketing conditions, deliveries, performance of the aircraft, and manufacturing. Improved air traffic and profits have not been translated into significant new orders for wide-bodied aircraft. Customers resold used L-1011's in effective competition with Lockheed's efforts to market new aircraft, but there are no longer used L-1011's on the market. Lockheed eliminated its risks on certain undelivered aircraft and on its obligations to dispose of others. Potential production scheduling problems may result from the Japanese airline's delay in exercising its purchase options, but these should be manageable. Customer response has continued to be favorable. Expenses remained within forecast, despite production rate reductions. A seperate section considers new versions of the L-1011 and the launch order for the Dash 500 model.

Lockheed began to report profits on an actual unit basis rather than the 300-aircraft program. In recognition of sales and cost uncertainties, it also began to write off initial program costs and costs associated with excess capacity.

The report considers Lockheed's non-L-1011 programs emphasizing that these comprise the bulk of its business and continued to be largely profitable.

For 1975, Lockheed's auditors continued to qualify their opinion on its financial statements on grounds related to the foreign-payments disclosures, the future of the L-1011 program, and certain unresolved claims. Overall net operating income was $45.3 million on sales of $3. billion, nearly double the 1974 income. Although L-1011 losses nearly doubled to $94 million due to reduced sales and increased charges, its profits on other programs increased 36% to $263. Lockheed's balance sheet continued to reflect the Company's high leverage. Although total assets and cash liquidity fell and accounts receivable increased, net worth improved substantially in 1975 but below forecast due to the delayed implementation of the financial restructuring plan.

Lockheed's operations through the third quarter of 1976 are also considered. Due to continued L-1011 losses, net income declined 16% from the comparable 1975 period; but, due to the continued profitability of other programs, it exceeded forecasts and further strengthened Lockheed's financial condition.

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

MEMORANDUM TO THE PRESS Dec. 31, 1976

United States Under Secretary of the Treasury for Monetary Affairs Edwin H. Yeo visited Portugal at the invitation of Finance Minister Medina Carreira. Mr. Yeo was also received by President Ramalho Eanes and Prime Minister Mario Soares.

The visit was part of continuing discussions between the United States and Portugal regarding economic and financial cooperation.

As the first phase of a program of assistance designed to achieve financial stability and recovery of the Portugese economy, the delegations of the two countries agreed on the essential principles for a $300 million line of credit for Portugal from the United States Treasury Exchange Stabilization Fund.

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WS-1243

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

202/634-5377
January 4, 1977

FOR IMMEDIATE RELEASE

TREASURY SECRETARY SIMON NAMES RICHARD B. SELLARS TO KEY VOLUNTEER POST FOR SAVINGS BONDS

Richard B. Sellars, Chairman of the Finance Committee of the Board of Directors, Johnson & Johnson, New Brunswick, New Jersey, has been named National Chairman of the Savings Bonds Volunteer State Chairmen's Council, one of the government's most important volunteer posts.

Mr. Sellars began a two year stint on January 1, 1977, as chairman of the Volunteer Council, which is composed of top volunteers from each state for the Bond Program in that state. An estimated 670,000 people annually do volunteer work of some kind for Savings Bonds.

The Volunteer Council meets once a year in Washington with the Secretary of the Treasury and other officials. In naming Mr. Sellars Treasury Secretary William Simon said " I am delighted that Dick has agreed to serve in this post. The Treasury is very appreciative of the Volunteer State Chairmen who, individually and collectively as the Council, lead our

- more -

WS-1244

country's efforts in the sale and promotion of Savings Bonds."

Mr. Sellars, a native of Worcester, Mass., joined Johnson & Johnson's Ortho Pharmaceutical Division in 1940. In succeeding years he became Vice President and Director of Ortho, and President of Ethicon, Inc., another Johnson & Johnson subsidiary. In 1950 he was elected to the Board of Directors of Johnson & Johnson.

In April, 1973, Mr. Sellars became Chairman of the Board and Chief Executive Officer of Johnson & Johnson, which manufactures medical and health care products in 40 nations. In November, 1976, he assumed his present position and continues as a member of the Executive Committee of the Board.

On accepting his volunteer Savings Bonds position Mr. Sellars said "I am pleased to be working with such a distinguished group of businessmen and professionals who believe in the Bond Program as strongly as I do. Together we will work to sell the Savings Bonds philosophy to more and more Americans in 1977."

Mr. Sellars has been active in many business, civic and professional activities. He is also Volunteer State Chairman for the Savings Bonds Program in New Jersey and has been a member of the U.S. Industrial Payroll Savings Committee.

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

FOR RELEASE AT 4:00 P.M.

January 4, 1977

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 $5,900 million, or thereabouts, to be issued January 13, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,400 million, or thereabouts, representing an additional amount of bills dated October 14, 1976, and to mature April 14, 1977 (CUSIP No. 912793 F6 8), originally issued in the amount of $3,508 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,500 million, or thereabouts, to be dated January 13, 1977, and to mature July 14, 1977 (CUSIP No. 912793 H9 0).

The bills will be issued for cash and in exchange for Treasury bills maturing January 13, 1977, outstanding in the amount of $5,911 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,682 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, January 10, 1977. 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 or at the Bureau of the Public Debt on January 13, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing January 13, 1977. 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, or from the Bureau of the Public Debt.

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

Memorandum for the Press: January 5, 1977

Attached are letters of transmittal from Treasury Secretary William E. Simon to the President of the Senate and the Speaker of the House of Representatives transmitting a Treasury Department report on "The State of the United States Coinage."

Queries should be directed to Frank H. MacDonald, Deputy Director of the Bureau of the Mint, (202) 376-0560.

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WS-1246

THE SECRETARY OF THE TREASURY
WASHINGTON

DEC 31 1976

Dear Mr. President:

With President Ford's approval, I am transmitting a report prepared by the Department of the Treasury on "The State of the United States Coinage."

The report identifies two major problem areas which should receive the attention of the Congress without delay. First, the report notes that the diminishing utility of the one-cent piece in the Nation's commerce and its increased production costs suggest giving serious consideration to eliminating the one-cent piece from our coinage system. In addition, the report recommends the replacement of the existing dollar coin with a smaller, conveniently-sized dollar, as well as the elimination of the half-dollar from the Nation's circulating denominations.

I respectfully urge consideration of the report and its recommendations by the Senate at the earliest feasible date.

Sincerely yours,

William E. Simon

The Honorable
Nelson A. Rockefeller
President of the Senate
Washington, DC 20510

Enclosure

THE SECRETARY OF THE TREASURY
WASHINGTON

DEC 31 1976

Dear Mr. Speaker:

With President Ford's approval, I am transmitting a report prepared by the Department of the Treasury on "The State of the United States Coinage."

The report identifies two major problem areas which should receive the attention of the Congress without delay. First, the report notes that the diminishing utility of the one-cent piece in the Nation's commerce and its increased production costs suggest giving serious consideration to eliminating the one-cent piece from our coinage system. In addition, the report recommends the replacement of the existing dollar coin with a smaller, conveniently-sized dollar, as well as the elimination of the half-dollar from the Nation's circulating denominations.

I respectfully urge consideration of the report and its recommendations by the House of Representatives at the earliest feasible date.

Sincerely yours,

William E. Simon

William E. Simon

The Honorable
Carl Albert
Speaker of the House
of Representatives
Washington, DC 20515

Enclosure

THE STATE OF THE UNITED STATES COINAGE

I. INTRODUCTION

After completion of a comprehensive review of United States coinage system requirements to 1990, the Treasury Department has identified substantial deficiencies in the existing system which require resolution in the near future. There are two major problem areas:

(1) the diminishing utility of the one-cent denomination in commerce, and

(2) the failure of the present half-dollar and dollar coins to circulate readily.

ONE-CENT COIN

The United States Government is rapidly approaching a decision point concerning continuance of the one-cent coin. The decision is prompted by the diminishing utility of the one-cent coin in commerce, causing ever-increasing production to compensate for high attrition of coins from the circulating supply. Inflation has a double impact because it increases the cost per transaction of keeping a one-cent coin in circulation while simultaneously decreasing the purchasing power of each cent transacted. The diminishing utility of the one-cent denomination in commerce is clearly evidenced by its high (14%) annual attrition from the circulating pool compared to the nickel (7%) and the dime and quarter (both essentially 0%). The attrition, which represents permanent voluntary withdrawal from circulation by the public, is directly related to the lack of purchasing power of the one-cent alone and, to a lesser extent, even to that of two, three, or four cents combined. Future increases in inflation are expected to create further corresponding increases in attrition rates which in turn place demand on the Mint for replacements, in a never-ending spiral.

Compounding the situation, estimated cost increases for coinage metal and manufacturing and distribution costs will cause the cost of producing the cent to exceed its face value by about 1980. In addition, the price of copper is projected to rise to such a level by 1990 that the cent coins may provide an economical source of copper for limited industrial consumption, adding to the rate of withdrawal of these coins from circulation.

If coin demand and economic market conditions meet current projections, and if the current coinage system remains unaltered, the present coin manufacturing capacity of the Bureau of the Mint must be increased about 20% by 1980, and must be almost tripled by 1990. This projected build-up of mint capacities will be solely for cent manufacturing. Presently cent manufacturing accounts for 75% of all coin production. By 1990, over 90% of capacity would be dedicated to manufacturing cents, which would cost about 2 cents for each coin produced.

Elimination of the cent coin at some later date would be a much more drastic action than elimination now, since in the future more production plant and equipment and more Mint employees would be affected by the precipitous reduction in production requirements.

Alternative one-cent coins which are less costly to produce have been examined. These alternatives would, of course, lower the production and distribution costs for a period of time but, in the best case, only to 1990, when cost would again exceed face value. Changeover confusion would also be considerable. Importantly, however, an alternate coin does not solve the basic phenomenon of decreasing utility in commerce and the increasing day-to-day transaction handling costs.

HALF-DOLLAR AND DOLLAR COINS

Presently, utilization is very low for the half-dollar and practically nonexistent for the dollar coin, due to the cumbersome size of these coins and the ready availability of convenient substitutes (2 quarters for the half-dollar and 4 quarters, or the dollar note, for the dollar coin). The alternatives are to continue manufacturing the present coins, to reduce the sizes, or to eliminate the dollar and half-dollar coin from the system.

EARLY CONSIDERATION

The problems with the present coinage system, as discussed above, are considered by the Treasury Department to be of such magnitude and widespread impact as to justify early consideration by Congress of whether changes in the Nation's coinage system are appropriate. In particular, a thorough public airing of the complex consumer issues is required. Decisions are needed to provide a proper basis for planning, budgeting and implementing actions by the Bureau of the Mint, the Federal Reserve System, commercial banks and businesses.

II. THE CURRENT COINAGE SYSTEM

The Secretary of the Treasury is responsible for the production of coins in such quantities as he determines necessary to meet the Nation's needs. The Secretary's statutory responsibility for the production of coins is carried out by the Bureau of the Mint, whose two major field facilities, the Philadelphia and Denver Mints, manufacture most of the country's coinage for circulation. Once produced, the coins are shipped by the Mint to the Federal Reserve Banks and branches, which, in turn, distribute the coins to commercial banks.

As specified by law, the Nation's coinage system currently consists of the following denominations: dollar, half-dollar, quarter, dime, nickel and the cent. All physical characteristics of the coins, including their alloy, size and weight, are specified by law. Since the late 1960's all denominations from the dime through the dollar have been made from a clad (sandwich) material which has thin outer layers of cupro-nickel (75% copper and 25% nickel) and an inner core of pure copper. The five-cent piece is made from an alloy consisting of 75% copper and 25% nickel; the one-cent piece is composed of 95% copper and 5% zinc.

The quantity of coins produced annually by the Mint depends essentially on public demand. The Federal Reserve System and the Mint jointly forecast the anticipated coinage requirements, and on the basis of the projections, the Bureau of the Mint prepares its operational and financial plans so that it can provide coins to meet the Nation's needs. The financial plans include all of the costs of making coins which, in addition to manufacturing expenses, cover the costs of coinage metal and the costs of distributing the coins to the Federal Reserve Banks. Thus, in Fiscal Year 1977 the Mint's estimated coin production of 12 billion pieces will cost the American taxpayer about $130 million.

Historically, the Nation's coinage demand has increased annually at a rate of approximately 10%. In more recent years, however, there have been abrupt deviations from this pattern. These deviations have been caused primarily by sharply varied demand for cents, the production of which accounts for approximately 75% of the Mint's total coinage output. By way of illustration, in Fiscal Year 1974 the coinage production of the Mint totaled 10.4 billion pieces, 8.4 billion of which were cents. During the next fiscal year, total coin production increased to 13.4 billion pieces with cents accounting for 10 billion. In Fiscal Year 1976, excluding the 3-month transition period, the Mint produced 12.6 billion coins, over 9 billion of which were one-cent pieces.

III. CONSEQUENCES OF RETAINING THE PRESENT COINAGE SYSTEM

The consequences of retaining the present coinage system can be derived from the experienced and projected growth in the demand for circulating coins. Production by the Bureau of the Mint increased from 2.7 billion coins in Fiscal Year 1961 to 12.6 billion in Fiscal Year 1976. With the present set of denominations, annual coin requirements are forecast to increase to 18 billion by 1980 and to 41 billion by 1990. To provide a basis for planning and implementing action by the Bureau of the Mint, several different methods and mathematical models have been developed for estimating future coinage requirements. The 18 billion figure for 1980 and the 41 billion figure for 1990 are in the intermediate portion of the range of forecasts which are provided by using the various methods and models.

The factors or relationships underlying the demand for cents are different from those affecting the demand for all other coin denominations. A stable relationship exists between the demand for nickels, dimes and quarters and the growth in retail sales, or similar measures of economic activity. Cent demand is less predictable due to the unique functions of this denomination in commercial transactions and the evident declining utility.

Normally, there is an expected correlation between the disappearance of cents from circulation (the attrition rate) and the estimated coin life of about 15 years. In recent years, however, there has been practically no correlation. On the other hand, the attrition rate, and in particular the growth in the attrition rate, appears to be more closely associated with the declining purchasing power of this coin. For example, two previous studies of samples of coins in circulation indicate attrition rates for cents of 4.8% in 1962 and 13.0% in 1973. Conservative projections indicate that this attrition rate will grow to about 21.0% by 1990. In effect, the public, by not bothering to keep these coins in circulation, has been "voting" over a protracted period of time for elimination of the one-cent piece from the United States coinage system.

The result of the experienced growth in cent attrition rates is that approximately two-thirds of the cents produced by the Mint in Fiscal Year 1975 were necessary to replace coins withdrawn from circulation. This proportion is projected to increase, as the utility of the cent declines, to the extent that by 1990 about 31 billion (82%) of the estimated production requirements of 37 billion cents would be solely to provide replacements for coins removed from the circulating pool. As the 1990 projected production of 37 billion cents would be about 90% of the expected total requirement for all denominations, cent projections are clearly the most significant impact on required production capacity and on total coinage system costs.

Current forecasts show that total coinage demand will exceed present Mint production capacity by about 1980, and will exceed present capacity by as much as two or three times by 1990. In addition, valuable resources and substantial costs would be involved in producing the tremendous number of one-cent coins, which would not circulate and which would be of limited value commercially.

The cost to the public of maintaining a coinage system includes all costs of the Mint in producing, handling and shipping its product. In addition, costs of handling, storing and distributing the coins by the Federal Reserve System, commercial banks and merchants are all passed to the consumer in one form or another. By this definition, the aggregate costs to our society of maintaining an adequate supply of cents have been estimated. The estimates were based on reasonable assumptions regarding increases in costs to the Mint of manufacturing and shipping coins. For example, the trend in copper prices was estimated to increase from the present figure of $.60 per pound to $1 per pound in 1980 and $1.50 per pound by 1990. Similarly, the costs of fabricating coinage metal, coining, and shipping were assumed to increase at an annual rate of 4%. Also, the 1975 estimated cost figure of $.03 per 100 coins for Federal Reserve and commercial banks to process cents was assumed to increase at an annual rate of 5%. On the basis of these types of assumptions, the total annual costs for maintaining the one-cent piece in the coinage system are expected to increase from the $81 million figure in 1975 to $189 million in 1980, and to about $693 million in 1990. These costs do not include the capital investment required to expand the Mint's production capacity.

As mentioned earlier, the current Mint production capacity will be exhausted by 1980. Development of additional capacity within existing facilities is not a total solution, nor in some cases is it a reasonable alternative, since these facilities already are overcrowded and have serious environmental and engineering deficiencies. Future capacity requirements will have to be met by constructing and equipping new mints, with the first major production increment needed by 1980. A new Denver Mint has been planned for this purpose.

This facility, when fully equipped, would have a capacity of 16 billion coins per year, at an estimated full capital investment cost of $86 million. To fulfill the 1990 projected requirement of 41.5 billion coins, additional capacity from the present base in the amount of 25 billion coins per year would be required. Extrapolating from the cost estimate for the planned new Denver Mint, by 1990 capital investment in the order of $200 million would be required to meet reasonable demand projections. Without the one-cent piece in the coinage system, additional capacity would not be required and, in fact, present Mint capacity should be sufficient until at least the year 2000.

IV. ALTERNATIVES TO THE PRESENT COINAGE SYSTEM

A. Elimination of the One-cent Coin

The one-cent piece would have to be eliminated soon in order to forestall the excessive costs to the public of maintaining in circulation a coin of so little value for commerce.

The cent has been the minimum U.S. coinage denomination since 1857, when Congress eliminated the half-cent. The purchasing power of a cent in 1917 was equivalent to that of a nickel in 1975, and (assuming a 5% inflation rate) to the projected value of a dime in 1990.

The costs associated with maintaining cents in circulation are rising. The present manufacturing cost, .7¢ per coin, is projected to increase to 1.5¢ per coin by 1990. However, the manufacturing cost is only a portion of the total cost to the public. In addition to these and other Governmental costs, commercial businesses incur costs for handling the large volume of cents. Considering the frequency with which the coin is handled, counted, packaged, stored and transported; the labor, materials, and capital equipment involved in the process; and the losses due to attrition, one can easily conclude that it costs our society more than a penny to transact a penny's worth of business.

Reduction of Production and Distribution Costs

Eliminating the cent would avoid an increasing annual cost to the public via a reduction in total coin production and distribution. As mentioned previously, the total annual costs to the American taxpayers of maintaining the cent in the coinage system are estimated to be $189 million in 1980, with a growth to about $690 million by 1990. Removing the cent from the system would not eliminate all of these costs, since there would be some increases in requirements for nickels and dimes due to the absence of the one-cent piece. Thus, reduction in costs is estimated to be about $150 million annually in 1980, and about $600 million by 1990. Also, expenditures of nearly $200 million for establishment of additional mint capacity to 1990 would be avoided if the cent were eliminated.

In addition to the reduced costs, removing the cent from the coinage system also would eliminate the consumption of valuable and increasingly scarce metal resources. With the present configuration and alloy of the cent, this "waste" of metal is in the order of 39,000 tons of copper in Fiscal Year 1977, with a projected growth to 129,000 tons by 1990. These are significant uses of a resource which has important military applications as well as wide commercial applications in the electrical, construction and transportation industries

Discontinuing cent production would reduce the manufacturing requirements of the Bureau of the Mint by more than 60%. Excluding this denomination, total production requirements to 1990 are not expected to exceed 7 billion coins annually, and present coin production capacity would be more than adequate to the 21st century.

Preferences of Affected Institutions and Individuals

While the Treasury Department has surveyed various affected institutions concerning the possible elimination of the one-cent piece, no attempt has been made to poll the general public. However, the Department has recently made several public statements which have generated limited response. As of the middle of November 1976, 146 letters had been received by the Department expressing an opinion on the subject. A tally of the letters indicates that 89% of the respondents are opposed to, and 11% in favor of, elimination of the one-cent piece. Most of those opposing elimination do so because of perceived inflationary effects and anticipated inconveniences in conducting cash transactions. The letters reflect the assumptions that individual items will have to be priced in five-cent increments, and that prices will always be rounded up. Some writers feel that elimination of the cent would be demoralizing, since it would be an open admission of continuing inflation and the worthlessness of our currency. Others fear the creation of a national or world impression that our monetary system is shaky. A sentimental attachment to the cent is reflected in a few letters which mention "children's piggy banks," and the "oldest coin," as reasons for not eliminating the cent. The small percentage of letters which welcome the elimination of the cent express the belief that the result would be increased consumer convenience and savings to the Government and to business, that would no longer have to deal with the coin. However, since a significant sampling of public opinion has not been conducted, the real attitudes and desires of the American people on this subject are not known at this time.

Retail firms and commercial banks recently surveyed by the Department have also expressed opposition to the elimination of the cent because of assumed inflationary impacts, as well as anticipated inconveniences which the absence of the cent would cause in cash transactions. Further, the overwhelming majority of state revenue departments opposed the discontinuance of cents, because of problems associated with the adjustment of existing state sales tax schedules and collection of tax revenues at the retail level.

The Perception of Inflation

There is a prevalent notion that eliminating the cent would generate an automatic increase in consumer prices. Although the inflationary impact has not been systematically studied, it does not necessarily follow that prices will rise. For example, absence of the cent in cash transactions does not mean that prices would have to be stated in five-cent increments. Many prices, particularly for items that typically sell in multiples or as part of a basket of different items (e.g., groceries), could continue to be quoted in one-cent increments. Rounding would occur only on the sum of purchases if payment was by cash, and not at all if payment was by check or credit card.

Furthermore, for those item prices that were changed to a five-cent increment basis, competitive pressures undoubtedly would lead to some rounding down as well as up. Over time, leads and lags in changing prices in five-cent increments should tend to average out. And pricing adjustments could be made in many cases through changes in packaging, or similar devices. Finally, the cost of keeping the cent in circulation is built into the current price structure; removing this cost should have a favorable price effect in the long run.

Transitional Considerations

If a decision to eliminate the penny were announced well in advance, commercial interests and state revenue departments would have adequate lead time to make the necessary accommodations. Although such an announcement would stimulate cent hoarding, the present stock of cents in circulation (45 billion), current Mint and Federal Reserve inventory (3.5 billion), and Mint cent production capacity (13 billion annually) should be adequate to avert a crisis during the transition period.

Summary

The primary advantage of eliminating the cent soon is that immediate resolution of the dilemma eliminates the cost of maintaining circulation and increasing mint capacity to meet an artificially-high demand, which is nearly all due to attrition caused by the coin's declining purchasing power.

Terminating cent production in the near future will permit the Mint to reduce its operating costs, as well as to avoid the expense of constructing new capacity. Deferring the decision to halt cent production will necessitate a costly expansion of manufacturing capacity, to be followed--when the decision is finally made--by a large-scale and more disruptive cutback than would occur now.

Retaining the cent indefinitely would require a large capital investment commitment by the Government. In 15 years the annual U.S. production of cents alone would exceed the quantity of all coins produced world-wide during 1974, and at a cost of nearly 2¢ per piece. Clearly, before that point is reached, cents will no longer be commercially useful and elimination of the denomination will be warranted.

B. The Dollar and Half-Dollar Coins

The existing dollar and half-dollar coins have no future roles in our coinage system because of their cumbersome size and the availability of acceptable substitutes. In recent years, the Mint has produced approximately 60 million dollars and 180 million half-dollars annually. These two denominations account for only 2% of the Mint's total production. According to projections of demand, there will be no significant increase in requirements for these denominations in the foreseeable future. In essence, production satisfies a numismatic-type demand, with coins produced being immediately withdrawn from circulation.

Potential Circulation

The basic rationale for a small dollar coin is to increase the flexibility for consumer transactions. The increased use of vending machines to save labor costs, and the higher prices for items which consumers are already accustomed to purchasing from machines, are expected to pursuade the public that the convenience of using vending machines outweighs any inconvenience of carrying an additional coin denomination. Moreover, the experience of other countries, notably West Germany, with its 2 Deutsche Mark coins (U.S. $.80), demonstrates that large denomination coins in the same range as the new dollar coin can circulate and

A recent survey of commercial banks and merchants conducted by the Bureau of the Mint, disclosed a desire by both groups that the present dollar and half-dollar coins be eliminated. Of all the groups surveyed, only the vending and coin equipment manufacturers gave a favorable response to the introduction of a new dollar coin. At the present time, with the exception of a limited supply of very expensive bill changers, there are no dollar vending machines.

Initial circulation would be very much dependent upon the production of dollar coin vending devices. At the present time, approximately 30% of vending machine sales are 60 cents or more. Despite industry survey results to the contrary, one must question whether dollar vending machines will be developed and installed on the speculation that consumers would obtain the coins and use them. However, a commitment on the part of the vending industry probably would be forthcoming if legislation were enacted to replace the existing dollar coin with a smaller, conveniently-sized coin.

Large scale production of automated machines which would accept dollar coins could be accomplished in 18 to 24 months after legislation is enacted. Considering the time required for production of new automated machines and the likely initial reluctance on the part of the banks, retailers and consumers to use the new coin, it would probably take 3 to 4 years after the passage of legislation to achieve wide-spread circulation.

Although the above discussion has focused on the replacement of the existing dollar coin with a smaller conveniently-sized dollar coin, the elimination of the half-dollar coin should be considered simultaneously. It, too, does not circulate and the introduction of a viable one dollar coin would seem to obviate its future usefulness.

Size and Material

The proposed new dollar coin would be sized between the existing quarter and half-dollar. Compared to the quarter, the diameter would be 10% greater and the weight 40% greater (the present half-dollar has twice the weight of the quarter). The weight of the proposed new dollar coin would be only one-third the weight of 4 quarters. The material recommended for the proposed smaller dollar would be cupro-nickel clad on copper (currently used for the dime, quarter, half-dollar and dollar coin), which has excellent wear and corrosion resistance and provides a greater degree of protection against "slugging" than a "non-sandwich" material.

Because of its value relative to other coins, the new dollar might be expected to be susceptible to slugging or counterfeiting. Vending machine and production technology, however, have reduced this risk to minimal proportions. In fact, dollar coin changers would be considerably less expensive and offer greater security than dollar bill changers.

Cost

The cost of producing the new dollar coin would be approximately 3 cents, compared to 6 cents for the present dollar coin and 1.5 cents for the $1 bill. Initial annual production requirements of 300 million dollar coins would cost the same ($9 million) as producing the current average of 60 million dollar coins and 180 million half-dollars. After the first few years the quantity produced is likely to increase. This may be offset by decreased requirements for the quarter dollar as new vending machines become available.

The new one dollar coin offers potential cost savings by supplanting some of the demand for one dollar bills. The coin would have an average life of 15 years, while the bill, costing 1.5 cents, lasts approximately 15 months. Thus it would take 12 bills, costing 18 cents, to provide the medium of exchange service life of one dollar coin, costing 3 cents.

It would be highly speculative, however, to attempt to project savings in $1 bill production in view of the number of uncertain inter-related variables--e.g., if initially the dollar coin became merely a numismatic item and did not circulate, production of $1 bills would remain high and there would be little or no savings; at the other extreme, if production of $1 bills were arbitrarily stopped there would be a savings of about $25 million. This savings would be partially offset by the increased demand for, and therefore cost of, $2 bills.

Summary

The present half-dollar and dollar coins have minimal utility due to their cumbersome sizes and the ready availability of convenient substitutes. Their manufacture should, therefore, be discontinued. Legislation should be proposed to permit the Treasury Department to manufacture a conveniently-sized dollar coin which would be slightly larger than the quarter. Strong interest by the automated coin handling manufacturers indicates that vending machines and dollar coin changers will be manufactured after such legislation is enacted. This should provide increased consumer flexibility and facilitate transactions for automatically vended products such as cigarettes and sandwiches.

and services such as mass transit usage. At the same time, consideration should be given to discontinuing half-dollar production since the introduction of a smaller dollar coin would further diminish the usefulness of a coin which is not presently used to any significant degree for commercial transactions.

V. PROPOSED ACTIONS

In view of the foregoing, the Department believes that the Congress should give serious consideration to the question of whether the cent is needed in our coinage system. The analyses conducted by this Department show conclusively that elimination of the cent after a suitable preparatory period, but no later than 1980, would eliminate substantial production and distribution costs.

However, no decision should be made without full scale public hearings and a thorough understanding of the impact on the consumer and the various institutions involved. The consumer issue is complex and will need to be thoroughly reviewed before determining the final course of action. The Department feels that the potential cost reductions and the diminishing utility of the cent warrant such a review at this time and will be pleased to cooperate in every way possible.

In addition, the Congress should authorize the replacement of the existing dollar coin with a smaller, conveniently-sized dollar, as well as the elimination of the half-dollar from the Nation's circulating denominations. Congressional review and analysis of these recommendations at the earliest feasible date are urged by the Department.

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

Contact: J.C. Davenport
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January 5, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES FINAL DETERMINATION OF SALES AT NOT LESS THAN FAIR VALUE WITH RESPECT TO FULLY AUTOMATIC DIGITAL SCALES FROM JAPAN

Acting Assistant Secretary of the Treasury Peter O. Suchman announced today that fully automatic digital scales from Japan are not being, nor are likely to be, sold at less than fair value within the meaning of the Antidumping Act, 1921, as amended. Notice of this determination will be published in the Federal Register of January 6, 1977.

A "Tentative Negative Determination", published in the Federal Register of October 4, 1976, stated that there was reasonable grounds to believe that the purchase price of fully automatic digital scales from Japan, is not less, nor is likely to be less, than the fair value of such or similar merchandise. Pursuant to that notice interested persons were afforded the opportunity to present oral and written views prior to the final determination in this case.

For purposes of this investigation, the term "fully automatic digital scales" means fully automatic digital scales that display weight, unit price and total price and have a weight measuring capacity of 25 lbs. or less. Customs made price comparisons on approximately 95 percent of the subject merchandise from Japan sold to the United States during the period May 1, 1975 through February 29, 1976 and found no margins.

Imports of the subject merchandise during the period investigated amounted to approximately 2300 units, valued at roughly $1.7 million f.o.b. Japan.

* * *

WS 1247

DATE: 1-5-77

TREASURY BILL RATES

52-WEEK BILLS

LAST MONTH 4.708 %

TODAY 4.728 %

HIGHEST SINCE: 11/76

5.201 %

LOWEST SINCE: ______

______

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

FOR IMMEDIATE RELEASE January 5, 1977

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $3,071 million of 52-week Treasury bills to be dated January 11, 1977, and to mature January 10, 1978, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 2 tenders totaling $12,740,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	95.231	4.717%	4.96%
Low -	95.210	4.737%	4.98%
Average -	95.219	4.728%	4.97%

Tenders at the low price were allotted 30%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted
Boston	$ 61,855,000	$ 17,855,000
New York	5,876,750,000	2,627,250,000
Philadelphia	16,055,000	1,055,000
Cleveland	182,045,000	57,045,000
Richmond	22,495,000	3,995,000
Atlanta	12,340,000	6,340,000
Chicago	222,615,000	87,515,000
St. Louis	54,320,000	18,320,000
Minneapolis	68,535,000	19,935,000
Kansas City	39,445,000	14,945,000
Dallas	30,130,000	11,630,000
San Francisco	466,600,000	204,800,000
Treasury	---	---
TOTAL	$7,053,185,000	$3,070,685,000

The $ 3,071 million of accepted tenders includes $ 74 million of noncompetitive tenders from the public and $ 1,204 million 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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WS-1248

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

FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE GERALD L. PARSKY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
THURSDAY, JANUARY 6, 1977, AT 10:00 A.M.

Implications of Oil Price Decisions

Mr. Chairman and Members of the Committee:

I am pleased to be here this morning to discuss the impact on the international economy and the international financial system of the decisions of the Organization of Oil Producing Exporting Countries (OPEC) with respect to the price of oil. The effects of OPEC's oil price decision in late 1973 are still being felt today. They will continue to be felt for years. The recent price increases only reinforce and intensify those effects. In my testimony today I would like to describe what policy actions we believe are called for. In order to do so, it is important to review in some detail (a) the economic and financial effects of the oil price increases, including those recently announced, (b) the world economic situation and outlook, and (c) the actions now under way to address the effects of the oil price increase.

WS-1249

Despite substantial recent progress, the world faces an overall economic situation which concerns us in many respects. It is true that the world has weathered the worst recession since the 1930s. Nevertheless even after a year of above average growth in the industrial world, unemployment rates remain extremely high and inflation is at levels that even five years ago would have been thought to be completely unacceptable. Moreover, a number of countries are becoming increasingly worried about how long they can continue borrowing externally to finance their payments deficits. The uncertainties have affected confidence which, in turn, has affected investment and future growth.

Obviously, the OPEC actions increasing the oil price have not been the sole cause of these economic difficulties. Failure to adopt sound domestic economic and energy policies in many countries has certainly contributed. However, the quadrupling of the oil price has been the largest single shock the international economy has experienced since World War II.

The immediate impact was a permanent loss in output -- in technical terms, a downward displacement of the growth path -- in the oil-importing countries. As a result it will be many years before we regain the levels of output and consumption we might have expected to attain in the absence of the oil price increase.

The costs of the adjustment which the price increase requires are substantial, so substantial that they have put severe strain on the prevailing social and economic structure of some nations. The result is that it has been very difficult for oil importing countries to develop and implement policies to facilitate the economic adjustments required. Where policy changes have been accepted, they have often been late or fallen short of the need.

Continued unsatisfactory performance in many economies, continued accumulation of external indebtedness, and concern over further OPEC price increases, have caused some to fear that the open trade and payments system may break down in a welter of restrictions on trade and defaults on debt. I do not believe that will happen because the governments of the world realize that in their own long-term interest, they must not allow it to happen. What is needed now is for these governments to convert this realization into action. The approach that we believe is necessary involves four main aspects:

1. Development and implementation of national energy policies to encourage cost-effective energy conservation measures and the development of alternate energy sources.
2. International cooperation on energy among oil consuming nations and with oil producing nations.

3. Adjustment and restructuring, through an appropriate combination of domestic economic policies and market-responsive exchange rate changes, of the pattern of external balances of the oil importing countries so that deficits on current account more nearly match a sustainable flow of capital to finance them.
4. Use of official sources of credit to encourage the adoption of appropriate adjustment policies and to augment available private financing during the period of adjustment.

To understand what is needed in each of these areas, let us look at some of the effects of the oil price decisions in more detail.

The Economic and Financial Effects of the Oil Price Increases

The external, largely financial effects of higher oil prices have captured the headlines, and I will discuss them shortly. However, I first want to point out that the financial effects are symptoms -- the basic effects are on the real economies of the oil importing countries. It is the magnitude, pervasiveness and severity of these real effects which has made adjustment to higher oil prices so costly, and in turn has intensified the disequilibria in international payments and associated strains in exchange and financial markets.

In order to give some idea as to the severity of these effects, we have attempted to estimate possible orders of magnitude for several of the major ones -- on real output, unemployment, and the price level -- for the U.S. economy. To do this, we simulated what might have happened to the U.S. economy between 1974 and 1980 in the absence of higher oil prices. While the results can only be taken as indicative of orders of magnitude, they indicate that the impact was of major proportions. In summary, the oil embargo plus the 400 percent OPEC price increases probably will cost the U.S. economy a cumulative loss in real output of about $500 billion over the period 1974-1980. In other words, we believe that over the remainder of the decade real GNP could have averaged approximately 5 percent higher each and every year in the absence of the OPEC actions of 1973-1974.

At the same time, prices (measured by the GNP deflator) could have averaged nearly 4 percent lower and unemployment rate perhaps 1-1/2 points lower over the 1974-1980 period.

It is important to note that several factors mitigated the economic and financial impact on the U.S. compared to other countries:

-- we are relatively less dependent on OPEC oil than many other nations;

-- U.S. firms have been very successful in increasing exports to OPEC markets; and

-- the sheer size and scope of the U.S. capital market has attracted capital inflows, both direct and indirect, in substantial volume.

Looking at the effects on the financial system, OPEC receipts from sales of their oil went from $23 billion in 1973 to $96 billion in 1974. The collective OPEC surplus -- the receipts from all international transactions not used to pay goods and services purchased from abroad -- went from $5 billion in 1973 to approximately $70 billion in 1974, $40 billion in 1975, and about $43 billion in 1976. Table 1 provides estimates of the world payments pattern for 1974-1976. Given higher prices and increased demand for oil, we currently estimate that the 1977 surplus will be higher than the 1976 figure. However, it is important to keep in mind that most people have underestimated OPEC import growth in the past; and recent evidence suggests that several countries have increased their spending. If this trend continues it could effect the 1977 OPEC surplus substantially.

In turn, the non-OPEC world experienced an increase in its net deficit of nearly the same magnitude, reduced only by the $1-1/2 to $2 billion annually of grant aid extended by OPEC countries to other nations. Obviously the deficit had to be financed -- thus OPEC asset increases have their counterpart in increased indebtedness of the oil importing nations to OPEC -- an increase of approximately $150 billion in the last three years.

This aggregate figure understates the actual problem somewhat since it nets out surpluses of a number of industrial countries. If we consider only deficit countries the total industrial country deficits aggregated roughly $110 billion during this period. Total non-oil LDC deficits were about $70 billion while the rest of the oil importing world ran aggregate deficits of some $35 billion. In other words, the total current account deficits in the oil importing world that had to be financed between 1974-1976 totalled up more than $200 billion. The deficits -- together with amortization payments on outstanding debt -- have had to be financed by some combination of reserve run-downs and borrowing, largely the latter. Roughly three quarters of this borrowing, has been provided by the private capital markets of the world. As an indication of the magnitudes involved, the medium-term Euro-currency credit and Euro-bond markets extended an estimated $65 billion (gross) in international credits during 1976 alone -- compared with $25 billion in 1973, the year before the oil price hike.

The recent OPEC price decisions involves much smaller percentage increases than the January 1, 1974 change. However, even an increase of 5 percent of $11.51, or $0.57 per barrel would have been 21 percent against the base of the mid-1973 price. Even more importantly, its effects have to be assessed within the context of current realities -- the unemployment, the inflation, the debt accumulation of January 1977. In this setting, even an increase of 5 percent takes on major significance.

-- a 5 percent increase adds over $6 billion directly to the world's oil import bill, including some $1 billion to that of the LDCs. Each 1 percent adds about $1-1/4 billion to the world's oil bill.

-- a 5 percent increase would further raise prices and reduce growth in the industrial countries, with subsequent effects on the LDCs.

-- any price increase could have significant effects in individual domestic economies which are vulnerable to psychological as well as economic shocks.

<u>The World Economic Situation and Outlook</u>

Turning to the world economic situation, the industrial countries, led by the U.S., Germany and Japan, began to recover from the 1973-1974 recession in early to mid-1975.

As has been the case in earlier cyclical upswings consumption and inventory restocking provided the major source of domestic stimulus with export growth also being of importance. The recovery proceeded in the "big three" countries and spread throughout the world economy until mid-1976, when a pause in the expansion appeared and began to spread. By the fall of 1976 a considerable slowing down in growth rates was being experienced in many of the OECD member countries, although the year-on-year average growth rates will still register solid expansion, with average OECD growth rates of about 5 percent. More recently, there have been signs of revival in the "leaders" -- U.S., Germany and Japan -- as indicated by such indicators as industrial production growth, new orders, stock market upturns, and surveys of investment intentions. This is particularly true of the United States. However, the revival is not widespread at this point or general within the industrial world, and the investment climate -- crucial for continued sustained growth, and for restructuring of domestic output and consumption patterns -- is still uncertain.

While average inflation rates for the OECD members as a whole continued to decline during 1976, they remained disturbingly high at 8 percent and only modest improvement is expected in 1977 even if the oil price increase is "only" 5 percent.

More disturbing is the extreme disparity in inflation rates (measured by consumer price indices) across countries -- currently ranging from 25 percent in Portugal and 20 percent in Italy to 1 to 4 percent in Switzerland and Germany respectively. Unless adjustment action -- including appropriate exchange rate change and domestic policy measures -- is taken, such disparities will cause continued movement in exchange and financial markets.

The OECD countries as a group are estimated to have had a current account deficit of some $23 billion in 1976, up sharply from the $6 billion of 1975. This reflects inventory adjustments and other effects of higher domestic growth on import demand; a substantial portion of this change is reflected in a reduction in the collective deficit of the non-oil LDCs.

The non-oil exporting developing countries appear to have reduced their current-account deficit in 1976 quite substantially. The 1976 improvement reflected an expansion of the LDC export markets in the recovering OECD countries, as well as slower growth rates in those LDCs which restrained their imports through demand management or direct controls.

Although real rates of growth in non-oil LDCs were lower in 1976 than the average of the past decade, the rates generally remained positive. This was possible -- in the face of costly oil imports, restrained import volume, and somewhat tentative export demand -- largely through heavy reliance on foreign borrowing. Whether the borrowing will be helpful or burdensome in the long run depends on the employment of these funds. Foreign borrowings have been used effectively by some LDCs to facilitate adjustment to external economic conditions and changes in relative prices. Debt servicing is not likely to be a problem for these countries. In other LDCs, adjustment has either proven to be a particularly difficult task, or has not received adequate governmental attention. In some cases, external borrowings have been used to maintain consumption levels and living standards in the short run: for these countries, debt servicing is more likely to be a problem.

The economic picture for 1977 remains disturbingly cloudy. Developments in the external sector are likely to exert pressures on a number of economies -- in terms of growth, inflation, and resulting employment conditions -- to a far greater degree than has been the case in any year since the 1960s except in 1974, the year of the quadrupling of the price of oil. Major adjustment policies recently enacted or in prospect will have significant interactive effects in Western Europe as well as effects on the LDCs -- in particular the African LDCs which are heavily dependent on European markets.

The OECD estimates that real growth rates in the industrial countries (OECD members) will average less than 4 percent in 1977, compared to 5 percent in 1976. The lower aggregate growth rate results partly from the fact that the "stronger" countries -- Japan, Germany, and the U.S. -- are entering a stage of the expansion when the growth rate usually begins to slow. Partly, however, it results from the fact that several countries which are implementing policies aimed at fostering fundamental domestic adjustment in response to external constraints partly by restraining growth of domestic demand -- will be growing quite slowly. The smaller OECD countries are expected to grow somewhat faster, while the non OPEC developing countries as a group are expected to experience somewhat lower growth in 1977. The non-market economies of Eastern Europe, faced with sizable reductions in the quantity -- and a considerable firming in the terms -- of external finance, may constrain domestic growth.

In the 1974-1976 period current account deficits were successfully financed -- to the surprise of many earlier doomsday forecasters -- as the international financial system proved to be flexible and resourceful. Lending through the private markets expanded dramatically and their activities were augmented by the IMF's Oil and Compensatory Finance Facilities as well as its regular facilities, and the EC borrowing network. Further, the non-OPEC developing countries have built up large reserve positions during the 1973-1974 commodity boom on which they were able to draw. Prior to the oil price increase, most industrial countries had made relatively little use of international borrowing for balance of payments reasons and had large untapped potential for obtaining external capital.

The oil importing world, however, enters 1977 under much less favorable conditions than existed in 1974. External debts, for the non-OPEC world as a whole, are about $200 billion higher. The bulk of the international borrowing has been of short- to medium-term maturity and will, in many cases, need to be rolled over or refinanced. As debt grows to finance the continuing deficits, private lenders are becoming more selective in their lending, and countries which have delayed adjustment will approach limits beyond which they cannot afford to borrow. Unused funds available to official institutions for balance of payments lending have also been reduced. This is a serious matter and it cannot be ignored by lenders or borrowers.

Management of the Impact of the Oil Price Increase

The world is beginning to take the steps necessary to deal with these effects of the oil price decisions. Some countries have been slow in acting, others must do much more. The effort is a painful one, which will inevitably leave all the oil-importing nations short of their aspirations but which is infinitely better than the alternative of a reversion to the beggar-thy-neighbor policies of the 1930s. In terms of our four-fold strategy, here is where we stand.

1) Domestic Energy Policies

The free world has made little progress since 1973 in reducing the vulnerability which stems from its over-reliance on imported oil. With economic recovery, demand has been increasing and in 1977 it is expected to rise over 1976 levels. For such trends to be reversed, the United States must assume a leadership role. Unfortunately, we have done just the opposite. Demand has been increasing, production declining, and our imports have grown. In 1973, we were importing 29 percent of our oil; in 1976, the figure is 41 percent. Not only has U.S. reliance on imported oil increased, but the proportion from OPEC has risen from 71 percent of oil imports to 82 percent.

Most Americans would agree that our goal should be to reduce our vulnerability to supply interruptions. However, it is not generally understood that to achieve that goal, adequate incentives must exist to reduce domestic demand and to develop alternative sources of supply. We should not be seeking zero imports. We can reduce vulnerability through reducing demand, diversifying supply and developing storage and emergency measures. However, if prices for oil and gas continue to be artificially controlled; if we continue to threaten divestiture of oil companies; if an adequate return on energy investment is not provided; the decisions necessary to bring on additional supplies simply will not be made in a timely fashion.

The development of a sound domestic energy policy was one of the highest priority items of the Ford Administration and I am sure it will continue to receive priority attention under the new Administration. Unfortunately, there is no single, easy solution to our energy problem. We need a series of actions in a number of very diverse areas ranging from measures to increase current fossil fuel production to basic research and development of alternative energy sources. Recently, Secretary Richardson and Administrator Zarb presented to the Congress a comprehensive status report on the development of our energy policy. I would like to focus today on only a few aspects of our domestic energy policy. These include:

-- The need to realize that domestically produced oil and natural gas must be priced realistically.

-- The need to maintain an investment climate which will ensure that private capital markets will be able to finance the energy industry without government financial assistance or intervention.

-- The need to achieve regulatory reform so as to simplify procedures, expedite approvals and licensing and, in general, free the energy industry from the governmental controls which hamper their ability to meet our national energy objectives.

Continued disparities in the prices of domestically produced oil and natural gas encourage a wide variety of distortions in both the producing side of the industry as well as in the consuming side. For example, the production of intrastate gas is far more valuable to the producer than the production of gas sold in interstate commerce. In addition, continued price controls on oil and gas delay and handicap the economic development of higher cost alternate resources such as geothermal or solar energy. In many instances, these sources are currently unable to compete with controlled prices without some government sponsored financial incentives.

To the consumer, the current composite pricing system fails to reflect either the true values of oil and gas or their replacement costs. Moreover, the price disparities and incentives inconsistencies have made it necessary for the government to establish an elaborate system of entitlements to equalize prices for refiners, adding further costs to both the consumer and the taxpayer. Even more serious, when the costs to the consumer are held to an artificially low level, the customer further delays the necessary steps which must ultimately be taken on conserving energy. As a recent study by the International Energy Agency noted, U.S. energy price controls keep U.S. energy costs artificially low when compared with those of other industrialized countries. For example, gasoline costs from 2-3 times as much in other industrialized countries as it does in the United States. Clearly, this cannot continue if we are to be serious in our effort to conserve energy.

Furthermore, adequate profits are necessary to raise the capital to replace the energy resources we are now consuming. In the absence of adequate prospects for profits, private investments in energy will lag and either (1) we will not develop the necessary domestic energy resources, or (2) the government, with its attendant bureaucracy and delays, will have to replace private development of new resources.

Uncertainties in the investment area lead to caution and hesitancy. Hesitancy in making investment commitments for development of new domestic energy resources will further delay reduction of imports to a manageable level. Besides the current regulatory, geological and environmental uncertainties, the potential for both horizontal and vertical divestiture have created new uncertainty for the industry which will undoubtedly cause deferments in investment commitments, just at the time when we want to encourage expanded efforts.

2) International Cooperation on Energy

At the same time that the United States must get its own energy house in order, we must pursue further cooperation among oil importers, through, among other fora, the International Energy Agency. Through this body, commitments have been made to share oil in an emergency. We should also formulate group objectives for reducing oil imports; undertake joint research and development projects; and more importantly, remove barriers to investment in energy.

A third interrelated element in energy policy must involve cooperation with the oil producing countries. In part, this can be accomplished through an energy dialogue which, among other things, should emphasize OPEC's responsibility in the world economic system. This is not only with respect to price but also to an increased role in the provision of official finance to support adjustment by those countries adversely affected by the direct and indirect effects of higher oil prices.

It is important to emphasize that although producers and consumers have different views on oil prices, there are many other more specific interests which are complementary. We should aim to develop such interest in various ways. For example, oil producers want to diversify their economies. They need goods and offer the faster growing market for oil-consuming country goods. Also, to industrialize, OPEC desires consumer country technical skill which producers are willing to pay for. The focus of consumer relations with the producers should be to strengthen these common bonds. We should not be pursuing a deliberate policy confrontation. Instead, we should bring producers and consumers closer together to foster greater understanding of each others' needs:

-- Consumers should understand the desires of the producers for diversification of their economies and for higher standards of living for their poeple.

-- Producers should understand that the rapid rise in oil prices has placed a great burden on all economies of the world -- economies which must remain viable and strong if producers are to grow and prosper.

Our objective should be to create the objective conditions which will bring about an expanding world supply of energy market prices.

The price increase of this past month, should not alter these basic policies. Rather, it should serve as a harsh reminder of how far we still need to go in developing these policies and that we must move with renewed haste.

3) Adjustment.

While many oil importing countries have been able to maintain growth rates by external borrowing, such loans ultimately represent claims held by the creditor countries against the future resources of the debtor. In order for a country to continue to borrow, it must be able to persuade creditors that it will be able to repay those borrowings sometime in the future. Thus, while countries will adjust at differing rates and under various policy choices, the common thrust must be to build up a domestic capital base which will be capable of producing goods in the future, including a sufficient portion that will earn foreign exchange. It is imperative that this capital base take into account the change in relative prices -- in particular energy prices. The future flow of production from larger current investments will assure rising income levels as well as permit the actual transfer of real resources to the OPEC countries when their import requirements begin to exceed their oil revenue. Unless such a capital base is built up, a country will have to reduce consumption substantially in the future when it comes time to amortize accumulated debts.

Progress is now being made on the adjustment of current payments patterns. A number of countries have taken or are in the process of taking action to reduce their current account deficits -- notably the U.K., Italy and Mexico. France has instituted a comprehensive anti-inflationary program, which should in time reduce both its domestic inflation and its external deficit.

Though important progress is now under way, more needs to be done. A continuing effort is needed, on the one hand to encourage countries to place greater emphasis on measures to adjust their payments imbalances and, on the other hand, to ensure that transitional financing -- private and official -- is available in adequate amounts while the adjustment takes place.

This means not only that the weaker countries must improve their positions; the non-OPEC countries in stronger positions must be prepared to accommodate this adjustment in their own trade and current account positions. The U.S., as one of those countries able to attract substantial capital inflows as a result of its relatively strong economic position, should be prepared to accept substantial trade and current account deficits in present circumstances. In an expanding economy these adjustments can be more easily absorbed.

Protectionist measures by the U.S. -- aimed at curbing imports or artifically stimulating exports -- would be self-defeating and would severely damage the system. Countries which are no longer able to borrow sufficient sums from private or official sources must adjust.

If U.S. policies frustrate the efforts of other countries to adjust through market-determined exchange rate changes and domestic macro-economic policy measures, they will be forced to adjust by resorting to direct controls on their trade and payment flows.

This would lead to a recurring series of protectionist reactions, as countries attempted to prevent further deficits. The ultimate outcome of such a policy would be a breakdown of world trade and worldwide economic stagnation. The adverse effects on the economic growth and welfare of the United States would also be substantial. And while the U.S. deficit might be reduced, it would not be eliminated.

4) Financing to Support Adjustment

Even with the adoption of appropriate adjustment measures by countries in deficit and those in surplus, transitional official financing has an important role to play in cushioning the pace and abruptness of the adjustments sought -- in permitting adequate time for rational, cooperative and deliberate policies to take force and have their effects. The provision of official financing, by supporting effective and responsible moves toward adjustment, can also play an important indirect role in assuring that private financing is available, because its promotion of adjustment measures will help provide the assurances needed by the private markets to enable them to play their necessary role.

Several measures to expand countries' access to sources of multilateral financing have been taken or proposed in the past year or so, many in response to U.S. initiatives. The IMF has significantly expanded access to its Compensatory Finance Facility, and this facility has provided nearly twice as much credit in the past year as it did in total during the preceeding dozen years of its existence. The IMF has created a Trust Fund for the benefit of its poorest developing country members, which will provide them with urgently needed balance of payments credit from the profits on sales of IMF gold. The IMF has expanded access to its regular credit facilities for all countries by 45 percent, pending implementation of proposed amendments to its Articles of Agreement. These amendments have been approved by the Congress and will, we hope, take effect by mid-1977. The IMF has acted to expand the list of currencies that are effectively usable in its balance of payments financing operations, a measure that can add significantly to its holdings of usable resources. And the IMF has available -- and is beginning to utilize, after a long period of inactivity -- the resources of the General Arrangements to Borrow, under which the U.S. and other major countries are prepared to lend supplemental resources to the IMF.

Looking somewhat farther ahead, a significant increase in IMF resources -- a 33.6 percent, SDR 10 billion increase in quotas -- has been agreed upon and is in the process of ratification by member countries. The increase in the U.S. quota has already been approved by the Congress, and we hope that others will follow suit shortly. Also, in recognition of the uncertainties in the present situation, IMF members have agreed to review quotas again in the near future -- in advance of the required quinquennial review. That review will begin in the next few months.

The IMF is in a unique position to provide the needed combination of economic expertise and financial resources to assist in the development of effective national stabilization and adjustment programs and lend the conditional credit needed to bridge the time from implementation to fruition of such programs. The IMF deserves and has received the strong support of the United States in its efforts as a major force for stability and cooperation in international economic affairs.

The list of measures to expand official sources of financing in the past few years is an impressive one. It is evidence of a general willingness on the part of countries to act cooperatively and constructively to meet rapidly changing and unprecedented world financial requirements. The need for substantial official balance of payments financing -- on a multilateral, conditional, and transitional basis -- will be with us for some time.

The measures taken to date, however, should not lead us to conclude that we have done all that may be necessary. While I remain optimistic that the world economy will survive the next year without financial disruptions, there are risks. Although private sector flows, supplemented by official flows through existing official facilities, should be adequate, there could develop a time when the stresses and strains become too great. Thus, we need to be prepared with a supplemental and temporary source of official financing.

The United States more than two years ago proposed such a facility -- the OECD Financial Support Fund -- but unfortunately it has failed to gain the support of the Congress to date and consequently has not yet been established. The Support Fund is designed to meet extraordinary needs for financing -- on the basis of firm policy conditions -- in a truly extraordinary situation. Most other OECD countries have ratified the Support Fund agreement, and U.S. action would bring the Support Fund into being. Legislation to authorize U.S. participation in the Support Fund has been resubmitted to this Congress, and I hope it will gain early passage.

Summary and Conclusion

Events of the past several years -- highlighted by the successive OPEC price actions -- have placed severe strains on the international economic and financial system. The problems posed by these strains -- which I have outlined for you -- can be dealt with only if we attack the real causes -- the economic, not just the purely financial. I have set out the strategy we believe is necessary to deal with out economic problems.

The world is beginning to carry out this strategy. The United States has an opportunity -- indeed, a responsibility to lead in this endeavor, by:

(1) moving ahead promptly to implement a sound national energy policy that will encourage cost-effective energy conservation and development of cost-effective alternative sources of energy;

(2) continuing cooperative efforts in international energy between both other oil consuming nations and the oil producers;

(3) keeping its markets open to foreign goods and services and pursuing the further reduction of trade barriers through the Multilateral Trade Negotiations;

(4) allowing its exchange rate to respond to market pressures; and

(5) supporting through multilateral channels, the provision of financial support where necessary, conditioned on the adoption and implementation of adequate adjustment policies.

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TABLE 1

World Payments Patterns

Rough Estimates of Current Account Balances (including official transfers)

($ billions, rounded)

	1974	1975	Est. 1976
OPEC	+70	+40	+43
OECD	-33	- 6	-22½
Non-Oil LDCs	-21	-29	-21
Others 1/	- 9	-15	-12½
Unexplained Residual	- 7 2/	+10	+14

1/ Israel, South Africa, Sino-Soviet area and Eastern European countries.

2/ A large portion of the residual is accounted for by oil settlements lags.

Source: 1974 and 1975 U.S. Treasury Department, 1976 OECD *Economic Outlook*, December, 1976, adjusted to conform to area definitions.

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

FOR IMMEDIATE RELEASE January 6, 1977

UNDER SECRETARY JERRY THOMAS
RESIGNS TO JOIN MARINE BANKS, INC.

Under Secretary of the Treasury, Jerry Thomas, announced today that he has submitted his resignation to President Ford effective January 20, 1977.

After leaving the Treasury post he has held since April 26, 1976, Mr. Thomas will become Chairman of the Board and Chief Executive Officer of First Marine Banks, Inc., a Florida-based multi-bank holding company which he founded in 1964. He held the same position before he entered the government.

As Treasury Under Secretary, Mr. Thomas, 46, served as a member of the Foreign-Trade Zones Board, as Chairman of the Board of Directors of the Federal Law Enforcement Training Center and as a member of the Board of Directors of the Securities Investor Protection Corporation. He also served on the Board of Directors of the United States Railway Association.

Prior to his government service, Mr. Thomas also served as Chairman of the Board of each of First Marine Banks' nine commerical banks. So that he might devote his full time to the holding company, he will not hold any position with the various banks.

Mr. Thomas is past-President of the Florida Senate and the former Director and Administrator of the Florida Securities Commission. Prior to entering commerical banking, he held membership on both the Midwest and the Philadelphia-Baltimore Stock Exchanges and headed his own investment banking firm in Palm Beach, Florida.

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WS-1250

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

FOR IMMEDIATE RELEASE
MONDAY, JANUARY 10, 1977
CONTACT: PRISCILLA CRANE (202) 634-5248

PUBLIC HEARING SCHEDULED ON REVENUE SHARING REGULATIONS

A public hearing has been scheduled on interim regulations relating to new public participation, public hearing, assurances and reports provisions of general revenue sharing law. The interim regulations were published in today's Federal Register by the Department of the Treasury's Office of Revenue Sharing.

"A public hearing on the interim regulations will take place on Friday, February 11, 1977, beginning at 10 a.m. in Conference Room 4121 at the Treasury Department, 15th Street and Pennsylvania Avenue, N.W., Washington, D. C.," Jeanna D. Tully, Director of the Office of Revenue Sharing, announced today.

A person who wishes to be heard on February 11, 1977 must submit to the Director of the Office of Revenue Sharing, an outline of the topics he or she wishes to discuss and an estimate of the length of time which will be required to discuss each topic. Ordinarily, ten minutes will be allowed to each participant. Requests to appear must be delivered to the Director, Office of Revenue Sharing, 2401 E Street, N.W., Washington, D. C. 20226, on or before February 4, 1977.

The interim regulations, which amend Subpart B of title 31, Code of Federal Regulations, have been put forward pursuant to the State and Local Fiscal Assistance Act of 1972, as amended by the State and Local Fiscal Assistance Amendments of 1976 (31 U.S.C. 1221, et. seq.).

The text of the interim regulations may be found in the Federal Register of January 10, 1977. Individual copies may be requested of the Public Affairs Division of the Office of Revenue Sharing at (202) 634-5248.

WS-1251

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

contact: Gabriel Rudney
(202) 566-5911

FOR IMMEDIATE RELEASE January 7, 1977

TREASURY SECRETARY ANNOUNCES MEMBERSHIP OF COMMITTEE TO ADVISE TREASURY ON TAX ASPECTS AND STANDARDS FOR PRIVATE PHILANTHROPY

Secretary of the Treasury William E. Simon announced today the appointment of a 25-member committee of private citizens to advise the Treasury on tax aspects and standards for private philanthropy.

C. Doublas Dillon, former Treasury Secretary and Chairman of the Metropolitan Museum of Art in New York, will be Chairman of the committee, to be known formally as the Advisory Committee on Private Philanthropy and Public Needs.

Secretary Simon, Mr. Dillon and a representative of Secretary of the Treasury-designate W. Michael Blumenthal attended the organizational luncheon of the advisory committee Thursday (Jan. 6) at the Treasury.

Secretary Simon told the group: "Establishment of this Committee is a direct outgrowth of the work of the well-known Filer Commission -- The Commission on Private Philanthropy and Public Needs. In December, 1975, that Commission, of which a number of you were members, or consultants, presented a report to the Congress and the Administration. It summarized that unique role of private giving in the history of the United States and provided abundant evidence that maintenance of a vigorous charitable giving sector is vital to the well being of the nation."

More than 200 recommendations for membership on the advisory committee came in after its establishment was announced in the Federal Register in November. Committee members will serve two-year terms without pay. Committee Coordinator is Gabriel Rudney of the Treasury Department.

Members of the advisory committee, in addition to Mr. Dillon, include:

Alan Pifer, President, Carnegie Corporation of New York.

George W. Romney, President, National Center for Voluntary Action, Washington.

Walter McNerney, President, Blue Cross Association, Chicago.

Leonard Silverstein, Attorney, Washingon.

Marion R. Fremont-Smith, Attorney, Boston.

Kingman Brewster, President, Yale University.

Ernest Osborne, Director, Sachem Fund, New Haven, Conn.

David Cohen, President, Common Cause, Washington.

John S. Nolan, Attorney, Washington.

William Matson Roth, President, San Francisco Museum of Art.

Leonard Conway, President, Youth Project, Washington.

Bruce Dayton, Chairman, Executive Committee, Dayton Hudson Corp., Minneapolis.

Thomas A. Troyer, Attorney, Washington.

Robert Blendon, Vice President, Robert Wood Johnson Foundation, Princeton, N.J.

H.J. Zoffer, Dean, Graduate School of Business, University of Pittsburgh.

Paul Ylvisaker, Dean, Graduate School of Education, Harvard.

Eleanor Sheldon, President, Social Science Research Council, New York.

James Joseph, President, Cummins Engine Foundation, Columbus, Ind.

Mary Gardiner Jones, President, National Consumers League, Washington.

William Aramony, National Executive, United Way of America.

Pablo Eisenberg, President, Center for Community Change, Washington.

John Filer, Chairman, Aetna Life and Casualty Company, Hartford

Vilma Martinez, President Mexican-American Legal Defense and Education Fund, San Francisco.

Wes Uhlman, Mayor, City of Seattle.

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DATE: January 10, 1977

TREASURY BILL RATES

	13-WEEK	26-WEEK
LAST WEEK:	4.407 %	4.555 %
TODAY:	4.613 %	4.803 %
HIGHEST SINCE 11/15/76:	4.890 %	5.018 %
LOWEST SINCE :		

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

FOR IMMEDIATE RELEASE

January 10, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,404 million of 13-week Treasury bills and for $3,501 million of 26-week Treasury bills, both series to be issued on January 13, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 14, 1977			26-week bills maturing July 14, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.839	4.593%	4.71%	97.579	4.789%	4.98%
Low	98.833	4.617%	4.74%	97.568	4.811%	5.00%
Average	98.834	4.613%	4.73%	97.572	4.803%	4.99%

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 84%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 20,575,000	$ 16,575,000	$ 41,030,000	$ 7,030,000
New York	3,808,040,000	2,053,615,000	5,194,915,000	3,239,815,000
Philadelphia	22,140,000	18,490,000	7,420,000	5,665,000
Cleveland	38,370,000	37,770,000	162,160,000	12,160,000
Richmond	22,535,000	22,535,000	20,165,000	7,505,000
Atlanta	26,700,000	26,670,000	14,545,000	13,545,000
Chicago	252,910,000	61,410,000	394,390,000	43,230,000
St. Louis	44,685,000	21,180,000	49,210,000	21,000,000
Minneapolis	20,980,000	12,980,000	21,240,000	13,240,000
Kansas City	55,135,000	47,690,000	18,430,000	18,180,000
Dallas	19,490,000	19,490,000	14,980,000	11,980,000
San Francisco	298,890,000	65,100,000	439,010,000	107,750,000
Treasury	- - -	- - -	- - -	- - -
TOTALS	$4,630,450,000	$2,403,505,000 a/	$6,377,495,000	$3,501,100,000 b/

/Includes $357,680,000 noncompetitive tenders from the public.
Includes $150,215,000 noncompetitive tenders from the public.
/Equivalent coupon-issue yield.

VS-1253

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

FOR IMMEDIATE RELEASE January 10, 1977

TREASURY DEPARTMENT-FEDERAL RESERVE
PRESS STATEMENT

The Treasury Department and Federal Reserve today announced that the United States will participate in the arrangements agreed in principle at Basle for a medium-term facility in the amount of $3 billion relating to official sterling balances. The U.S. participation in this standby facility will be in the amount of $1 billion. It will be provided through the Federal Reserve System and the U.S. Treasury Exchange Stabilization Fund.

The purpose of these arrangements is to reinforce the international monetary system by helping the United Kingdom achieve an orderly reduction in the reserve currency role of sterling and in this connection to facilitate the funding of a portion of Britian's external liabilities. The Bank for International Settlements will cooperate in the arrangements and the Managing Director of the International Monetary Fund is being asked to assist in their implementation. These sterling balance arrangements will reinforce the economic program undertaken by the United Kingdom in connection with the $3.9 billion standby agreed with the International Monetary Fund on January 3, 1977. A copy of the press announcement made by the central bank group in Basle is attached.

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Attachment

WS-1254

BIS Press Communique

Discussions have recently been taking place between the United Kingdom and the other Group of Ten countries and Switzerland on the subject of sterling balances. These discussions follow the successful conclusion of the United Kingdom's application to the International Monetary Fund and were prompted by a shared determination to make a joint contribution to greater international monetary stability.

Fluctuations in the official sterling balances have at times in the past been disruptive to the United Kingdom's economic policies and to the international monetary system. The aim in the discussions has therefore been to prevent such instability in the future. In these circumstances, there was general welcome to the United Kingdom's declared policy to achieve an orderly reduction in the reserve currency role of sterling.

To support these aims, agreement in principle has been reached by governors of the central banks concerned, on a medium-term financing facility in the amount of $3 billion related to the official sterling balances, which at end-September were valued at $3.8 billion. This stand-by facility will be provided to the Bank of England by the BIS, backed up by the participating countries. The Managing Director of the International Monetary Fund is being requested to assist in the implementation of the agreement.

The participating countries are Belgium, Canada, Germany, Japan, the Netherlands, Sweden, Switzerland and the United States of America. Other countries may wish to participate later.

As part of the operation the United Kingdom intends to offer securities in the form of foreign currency bonds to present official sterling holders.

1-10-77

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. January 11, 1977

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 $5,900 million, or thereabouts, to be issued January 20, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,400 million, or thereabouts, representing an additional amount of bills dated October 21, 1976, and to mature April 21, 1977 (CUSIP No. 912793 F7 6), originally issued in the amount of $3,402 million (an additional $2,006 million was issued on December 10, 1976), the additional and original bills to be freely interchangeable.

182-day bills, for $3,500 million, or thereabouts, to be dated January 20, 1977, and to mature July 21, 1977 (CUSIP No. 912793 J2 3).

The bills will be issued for cash and in exchange for Treasury bills maturing January 20, 1977, outstanding in the amount of $5,904 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,613 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, January 17, 1977.
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 or at the Bureau of the Public Debt on January 20, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing January 20, 1977; provided, however, that settlement for tenders submitted to the Bureau of the Public Debt must be completed on January 21, 1977, and must include one day's accrued interest if settlement is made other than Treasury bills maturing January 20, 1977. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differences between the 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, or from the Bureau of the Public Debt.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

January 11, 1977

MEMORANDUM FOR THE PRESS:

John M. Porges has resigned as U.S. Executive Director of the Inter-American Development Bank and as Special Assistant to the Secretary of the Treasury, effective January 13, 1977. He has held the posts since June 1973.

Mr. Porges will join the Cavendes Investment Banking Group in Caracas, Venezula, with responsibilities for their international operations.

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WS-1256

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
AT THE
U.S. INDUSTRIAL PAYROLL SAVINGS COMMITTEE MEETING
DIPLOMATIC FUNCTIONS SUITE, STATE DEPARTMENT
WASHINGTON, D. C., JANUARY 12, 1977

Thank you for your report, George. You and your committee should be very proud of the results. We at Treasury wish to express our sincere thanks for your dedicated service.

And now, to acknowledge the efforts you have made on our behalf, it is my pleasure and privilege to present a number of awards.

First, to the outgoing 1976 committee. If all the 1976 members will please stand. In grateful appreciation of the excellent service you have given to the payroll savings program and to the nation, we would like to present each of you with the Department of Treasury's silver medal of merit.

I would also like to read one of the letters that accompanies this award. Each letter differs, of course, depending upon your assignment. This letter is to Bill Miller and I would like to ask him to step forward at this time.

"Dear Bill:

"I am deeply impressed with the contributions you and the other members of the U.S. Industrial Payroll Savings Committee made to the success of the savings bonds campaign during our bicentennial.

"The enrollment of payroll savers exceeded the challenging goal of 2,500,000. The sale of small denomination E - Bonds was $4,900,000,000, the greatest amount since 1945."

"You played a significant role in these remarkable achievements as the chairman for the Electrical Equipment Industry. Your efforts benefited the nation and the individual citizen. It is with special pleasure that I present to you the attached medal of merit."

The letter carries my signature as Secretary of the Treasury. I would now like the savings bonds people to present the various chairmen with their individual silver medals of merit.

The second group of awards I have goes to the distinguished past chairmen of this committee -- all of whom, as you know, continue to serve.

If Bill Gwinn will please come forward, I would like to read the inscription on this liberty bell trophy.

WILLIAM P. GWINN
PRESENTED BY TREASURY SECRETARY WILLIAM E. SIMON
FOR PATRIOTIC SERVICE
JANUARY 12, 1977

Our other former chairmen present today -- all of whom will receive their liberty bell trophy by mail -- are Gabriel Hauge for 1975, John deButts for 1974, and Don MacNaughton for 1972. My thanks to all of you.

Finally, I have two awards for our distinguished outgoing chairman, George Stinson. As you have heard, the committee did a magnificent job under his leadership. They exceeded the highest goal ever accepted by a committee -- 2,500,000 new and increased savers. This goal was an increase of 100,000 over last year. George's energy, direction and dedication made this accomplishment possible, and in turn, made possible the total of more than 7-1/2 billion dollars in Series E and H sales for 1976 -- the best since 1945 and over 500 million more than 1975. It has been a great personal pleasure for me to work with George. His stature in the Business community is one that can be matched by very few.

George, if you will come up here, I would like to present you with this framed parchment citation. It reads:

> "George A. Stinson, Chairman, U.S. Industrial Payroll Savings Committee. For exceptional achievement in the 1976 payroll savings campaign, 'take stock in America -- 200 years at the same location.'
>
> "Under his leadership, and inspired by his example, American industry during our bicentennial year exceeded its challenging goal of enrolling 2,500,000 savers and raised the sale of Series E bonds through the payroll savings plan to a new record. This contribution to the security of both individuals and the nation is an impressive tribute to his efforts.

"His generous service is in the finest tradition of the volunteer spirit that characterizes the savings bonds program.

"Given under my hand and seal, this twelfth day of January, Nineteen hundred and seventy-seven."

I also have for you this beautiful gold medal of merit.

The inscription on the case reads --

MEDAL OF MERIT
AWARDED
GEORGE A. STINSON
FOR
DISTINGUISHED LEADERSHIP
AS 1976 CHAIRMAN
U.S. INDUSTRIAL PAYROLL SAVINGS COMMITTEE
BY
WILLIAM E. SIMON
SECRETARY OF THE TREASURY
JANUARY 12, 1977

Although I have no formal awards for them, I would like at this time to express my deepest thanks and appreciation to Mrs. Francine I. Neff, National Director of the Savings Bonds Division, Mr. Jesse Adams, Deputy Director, Chuck Goodall, Executive Secretary of the Committee, and the entire Savings Bonds division staff, for the splendid support they have given this committee. I am sure you will agree that without their help and guidance, the year's results would not have been possible.

And now I would like to take just a few minutes to talk about the state of our economy, the place of savings bonds in it, and your role in the world of savings bonds.

While recovery from the recession is far from complete, the U.S. economy is back on a path of economic expansion and is making good progress. Since the current expansion began in early 1975 the "real" output of goods and services has increased at an annual rate of 6.4 percent -- well above this nation's underlying growth potential of about 3-1/2 percent each year. Personal consumption, business spending, housing construction and government spending have all risen -- again in "real" terms with price changes removed -- during this expansion and the overwhelming consensus view both inside and outside of government is that economic growth at above-average rates will continue into 1977.

Nevertheless, we are justifiably concerned about the slowdown of activity in recent months which has been sharper and more prolonged than expected. There are specific reasons for this slowdown -- or "pause" as it sometimes is called -- including the unusual number of workers out on strike throughout the third quarter and the sluggishness of business spending for plant, equipment and added inventories. But I believe that the underlying cause is not to be found in any list of temporary distortions. Instead, the real issue involves the weakened confidence of the American people in their economic future.

By concentrating on the details of the latest economic statistic, we have missed the broader message for economic policy: a basic need for sustained economic growth in which government fiscal and monetary policies are consistent with the pace of private sector activity. The disappointing economic distortions of the last decade will continue unless three policy adjustments are made:

-- First, the diversity of economic problems must be better recognized to avoid concentrating on single issues. Inflation, unemployment, sustained output, the availability of productive resources, financial markets and the impact of regulation must all be considered simultaneously to create balanced growth.

-- Second, when new policies are initiated they should solve more problems than they create. During a period of difficulty it is expedient to "do something" quickly to demonstrate political leadership. This naive activist approach often causes even more problems after the temporary benefits disappear. The conventional wisdom that a few billion dollars of additional government spending somehow makes the difference between the success or failure of the entire U.S. economy -- which is rapidly approaching an annual level of output at two-trillion dollars -- is an unfortunate economic myth. This approach to government spending resulted in the Federal budget outlays rising from $135 billion in fiscal year 1966 to $268 billion in FY 1974 and then jumping to a level of at least $413 billion in the current fiscal year 1977. It should come as no surprise to anyone that we have reported a Federal budget deficit in 16 of the last 17 years -- and 39 of the last 47 -- climaxed by a combined shortfall of Federal deficits and "net" borrowings for over 100 federal credit programs not even included in the budget of almost one-half of a trillion dollars in the last 10 fiscal years (includes FY 1977). This dismal record and the resulting impact on monetary policies is hardly a "confidence-inspiring" experience for American consumers and businessmen.

-- Third, there is a fundamental need to adopt economic policy goals for longer time horizons that stretch beyond the next scheduled elections. The fine-tuning approach keyed to political needs has led to many of the distortions experienced over the years.

Such general recommendations may not attract much immediate attention as most analysts concentrate on the details of the preliminary monthly economic statistics which are released each day. Nor is it easy to force the consideration of specific spending and tax decisions into a broader framework of long-term economic stability goals.

But unless we rapidly change our approach to determining and coordinating national economic policies, I anticipate that we will continue to experience the disappointing combination of inflation and unemployment, along with the volatile shifts in the output of goods and services, that has plagued the U.S. economy for more than a decade. If this happens the improvement in confidence that is so badly needed will not occur.

Now, where do savings bonds fit into all of this? Well, the bond program has always had two goals -- two roles -- since it began over 35 years ago.

On the one hand, U.S. savings bonds give millions of individual Americans greater financial security through providing a method for saving that is totally safe and very convenient.

On the other hand, the program helps America itself, by providing the government with a dependable, long-term foundation for its national debt structure.

The numbers are significant. As of December 31, 1976, outstanding public debt of the Treasury, including matured and non-interest bearing debt, stood at over $653.5 billion.

Some $241 billion of the total debt was held by the Federal Reserve Banks and the government trust accounts, such as social security and unemployment trust funds.

The problem area for us was the $413 billion of debt in private hands. Of this, around $312 billion was in the form of marketable securities, such as Treasury bills and notes. An additional $29 billion was in non-marketable securities other than savings bonds, leaving $72 billion in series E and H bonds and remaining freedom shares. As a quick calculation will show, slightly less than one fifth of the privately-held portion of the public debt was in savings bonds -- a sizable amount. Although savings bonds holdings have increased by over $4 billion in the past year, their share of the privately-held public debt has declined because of large increases in the debt. That the ratio of savings bonds holdings to the privately-held public debt has not fallen even further is largely due to your efforts.

But more important than percentages, savings bonds holdings broaden and stabilize the government's debt base. Millions of people buy these bonds, and they hold them twice as long as marketable securities. Specifically, privately-held marketables are held an average of 2.9 years while savings bonds are held an average of 6 years.

The life of privately-held marketables has declined in recent years and this causes considerable concern to economists. Because we must then go into the market to refund more often and each refunding raises serious issues of pricing and marketing strategies. Even eliminating the shortest term securities, Treasury bills, about $1 out of every $6 of marketable debt must be refunded and replaced within a year. Savings bonds, however, based on past performance require only about $1 out of every $9 refunded within a year -- and that's a significant difference.

These bonds, then, are critical to good debt management, but their other role is even more important. This is to provide individual Americans with financial security through a safe, convenient way to save.

Consider that the cornerstone of any personal financial program is a block of highly liquid securities convertible to a known amount of cash at almost any time. This is savings bonds.

Safety is a key feature. In addition, payroll savings is the most realistic way ever devised to save money. The financial writer, Sylvia Porter, has written that, some years ago, she and her husband started to save money by buying a monthly savings bond. But they decided the then-interest rate was too low so they stopped and told themselves they would put the same amount into another account. Three or four months went by and, said Mrs. Porter, they discovered they hadn't put one penny into their account without the incentive of an automatic bond-buying plan. Payroll savings turns a good impulse into a regular habit -- and six percent of a good habit is better than any percent of a good idea that never takes off.

The interest rate for bonds is well placed in the spectrum of available savings instruments, and there are some very attractive tax benefits. Beyond this, savings bonds is a personal thrift program that works in an era which desperately needs to remember, and practice, the values of thrift and individual responsibility.

I think people know this. They respond to efforts to help them help themselves. Our 1976 bicentennial year bond sales of $7.5 billion were the highest since 1945 and were 53 percent over a decade ago.

Thrift is an American tradition. And so is volunteerism. You are all special volunteers and I'm pleased that 99 percent of all people who help Treasury to sell bonds are volunteers. You, and they, make it possible to do the job with only a small handful of government employees. Because of your help we do not need to add another layer of government bureaucracy.

If I might add just a word about another volunteer group: The Advertising Council, through its professional help and donated space, provides us with the equivalent of $75 million worth of advertising a year. They've helped us for many years -- and you will find their contributions of immense benefit in your own work for savings bonds.

Another aspect of your volunteer service is that, unlike many federal programs, you and savings bonds build on the strength of our citizens. You, and savings bonds, speak to the good and the strong in people -- to their care for their families and their love of country instead of to their fears or faults or failures. Through you millions of citizens achieve a better and a fuller life and isn't that the real purpose -- the bottom line -- of what we all want in this country? I think so -- and that's what makes us the great nation that we are.

And now, if I may add a personal note:

My time as Treasury Secretary has been stimulating and exciting, and I don't regret one day of it. But, looking backward and forward, I know that one of my lasting satisfactions will be my association with the savings bonds program. It is a good program -- a people program -- one that unabashedly advocates personal responsibility for a man and woman's own financial security. And it is a program built around volunteers.

I know that we ask a lot of our volunteers. We ask for that precious commodity -- your own time. We ask you to become personally concerned and involved in selling an idea -- personal thrift -- and a practical method whereby the idea can be carried out. We can do this only because we feel the idea and the product is so great.

I believe that, when <u>your</u> time for serving with this program is over -- and the results are in -- you will feel, as I do, a sense of great personal satisfaction. Each one of you, as a member of the U.S. Industrial Payroll Savings Committee, is a vital force in this program. It is important to the government's debt management. It is important in providing security to individual Americans. Your continuing efforts mean a great deal to all of us. On behalf of the government -- and its citizens -- thank you and good luck.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. January 12, 1977

TREASURY TO AUCTION $2,500 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $2,500 million of 2-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 at the average price of accepted tenders.

Details about the new security are given in the attached highlights of the offering and in the official offering circular.

Attachment

WS-1258

HIGHLIGHTS OF TREASURY OFFERING TO THE PUBLIC OF 2-YEAR NOTES TO BE ISSUED FEBRUARY 3, 1977

January 12, 1977

Amount Offered:

To the public	$2,500 million

Description of Security:

Term and type of security	2-year notes
Series and CUSIP designation	Series L-1979 (CUSIP No. 912827 GJ 5)
Maturity date	January 31, 1979
Call date	No provision
Interest coupon rate	To be determined based on the average of accepted bids
Investment yield	To be determined at auction
Premium or discount	To be determined after auction
Interest payment dates	July 31 and January 31
Minimum denomination available	$5,000

Terms of Sale:

Method of sale	Yield Auction
Accrued interest payable by investor	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less
Deposit requirement	5% of face amount
Deposit guarantee by designated institutions	Acceptable

Key Dates:

Deadline for receipt of tenders	Wednesday, January 19, 1977, by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds	Thursday, February 3, 1977
b) check drawn on bank within FRB district where submitted	Monday, January 31, 1977
c) check drawn on bank outside FRB district where submitted	Friday, January 28, 1977
Delivery date for coupon securities	Thursday, February 3, 1977

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: James C. Davenport
Extension: 2951
January 13, 1977

FOR IMMEDIATE RELEASE

TREASURY DEPARTMENT ANNOUNCES PRELIMINARY COUNTERVAILING DUTY DETERMINATION ON ITALIAN TOMATO PRODUCTS

Under Secretary of the Treasury Jerry Thomas announced today the preliminary determination that imports of canned tomatoes and canned tomato concentrates do not benefit from the payment or bestowal of a bounty or grant within the meaning of the U.S. Countervailing Duty Law (19 U.S.C. 1303). Notice of this determination will appear in the Federal Register of January 14, 1977.

The Countervailing Duty Law requires the Treasury to assess an additional (countervailing) duty that is equal to the amount of a bounty or grant (subsidy) when one has been found to be paid or bestowed. The program that is the subject of this investigation was basically designed by the Italian government as an emergency measure during 1975 for the purpose of dealing with adverse economic conditions in the industry during that year. Although payments were made under the program, they were small in relation to both total production and exports. More important, all payments have been suspended by the Italian government and are not expected to be made in the future. Accordingly, a preliminary negative determination was reached.

Interested parties will have 30 days from the date of publication in the Federal Register in which to present written views regarding this action. A final determination must be issued by no later than July 2, 1977.

Imports of canned tomatoes and canned tomato concentrates from Italy during 1975 were valued at approximately $7.3 million.

* * *

WS-1259

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

January 19, 1977

RESULTS OF AUCTION OF 2-YEAR TREASURY NOTES

The Treasury has accepted \$2,504 million of \$5,523 million of tenders received from the public for the 2-year notes, Series L-1979, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	5.94%
Highest yield	5.99%
Average yield	5.97%

The interest rate on the notes will be 5-7/8%. At the 5-7/8% rate, the above yields result in the following prices:

Low-yield price	99.880
High-yield price	99.787
Average-yield price	99.824

The \$2,504 million of accepted tenders includes \$371 million of noncompetitive tenders and \$2,133 million of competitive tenders (including 80% of the amount of notes bid for at the high yield) from private investors.

In addition, \$335 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

WS-1260

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE GERALD L. PARSKY
ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
COMMISSION ON SECURITY AND COOPERATION IN EUROPE
FRIDAY, JANUARY 14, 1977, AT 10:00 A.M.

Mr. Chairman and Members of the Commission:

It is a pleasure to appear before this Commission to discuss implementation of Basket II of the Final Act of the Conference on Security and Cooperation in Europe (CSCE). As Executive Secretary of the East-West Foreign Trade Board and Chairman of its Working Group, I welcome these hearings as an opportunity to clarify the meaning and relevance of Basket II of the Final Act, and the possibilities for East-West economic cooperation which it offers. I hope that our discussions today can provide guidance to the new Administration and the new Congress to implement further the Final Act, and in so doing facilitate future East-West economic cooperation.

I commend the Commission for its hard work in monitoring implementation of the Helsinki Agreement, and for its efforts to encourage private and governmental projects and programs which will take advantage of provisions of the Act to expand East-West economic cooperation and human contact. I also applaud the initiative demonstrated by the Commission in its inquiries and studies in this area, which has been only slightly understood.

In signing the CSCE Final Act, the United States, Canada and 33 European States, including the Soviet Union and the countries of Eastern Europe, undertook a significant moral and political obligation to carry out its provisions. It is a broad document touching on a wide range of issues grouped together in three Baskets.

Basket I contains a Declaration on a ten-point listing of the principles agreed upon by the signatories to guide relations between them; Basket II contains provisions on cooperation in the fields of trade, industrial cooperation, science and technology, environment and other areas of economic activity; and Basket III includes provisions on humanitarian principles involving the freer movement of people, ideas, and information. In my remarks today I will focus on the progress and prospects for resolving economic issues which hinder the successful implementation of the Basket II provisions.

Basket II, like the rest of the Final Act, contains no legally binding commitments by its signatories to adopt specific policies or programs which would facilitate East-West economic cooperation. But it does provide a framework in which patterns of cooperation in this area may emerge. In Basket II, the Eastern and Western signatories expressed their intention to work together to develop their cooperation in the economic, scientific and technical spheres of activity.

Basket II should be viewed as a basic economic charter leading toward specific steps by governments and nongovernmental institutions on a unilateral, bilateral and multilateral basis.

U.S. Interests in Improved Economic Cooperation with the East

Basket II of the Final Act complements U.S. interests in expanding East-West economic cooperation. The central theme running throughout this Basket is that economic contacts are a natural outgrowth of improved political relations -- and contribute, in turn, to the stability of these relations. In signing the Agreement the Participating States endorsed the conviction that "their efforts to develop cooperation in the fields of trade, industry, science and technology, the environment and other areas of economic activity contribute to the reinforcement of peace and security in the world as a whole." This is precisely the concept that has underscored U.S. efforts to develop economic cooperation with the East in these fields over the past few years.

During the Cold War period, U.S. participation in trade with the Communist countries was virtually non-existent. No cooperative efforts were undertaken either in the economic and commercial fields or in science and technology. It was difficult to speak of bilateral relationships with these countries in any meaningful way. As a result there was no inducement toward cooperation and little incentive for restraint.

The Cold War policy of sharply restricted trade and broad embargoes against the Communist countries came to be seen as ineffective in either altering the nature of their systems or materially improving their policies toward the Western world. It was also increasingly recognized that this policy was counterproductive to U.S. economic interests for several reasons:

-- East-West trade continued to expand more rapidly than world trade despite the lack of significant U.S. participation;

-- Western Europe and Japan were vigorously gaining access to Eastern markets with government backed credits which the U.S. continued to withhold; and

-- The U.S. was suffering serious balance-of-payments difficulties, and increased trade with the East could generate healthy surpluses.

At the same time, the Soviet Union and the countries of Eastern Europe came to realize that they could not provide for increasing consumer demand or meet the technological requirements of the more sophisticated economies they were seeking solely from their own economic resources. As a result they moved toward greater economic contact with the West.

Faced with these developments, the U.S. Government has, in recent years, sought to implement a policy of detente, in which the attempt to normalize U.S. economic relations with the Soviet Union and Eastern Europe has been an important element.

Stronger economic bonds between the U.S. and the Communist countries have been a critical element of this policy. Economic and political relationships are inevitably intertwined, and improving economic relations can only develop in the context of a stable political environment. But closer economic ties can also help create an environment for progress on political issues. It has therefore been in our economic interest to work to intensify our economic relationships with the Communist world.

At the outset of this new approach, we achieved some notable accomplishments.

In the Moscow Summit in May 1972 former President Nixon and Secretary Brezhnev signed the Basic Principles concerning the development of U.S.-Soviet political and economic relations. Among these principles the two leaders agreed that economic and commercial ties were an "important and necessary element in the strengthening of U.S.-Soviet relations."

Following this meeting, the United States began negotiating a series of agreements designed to improve our economic relations with the Soviet Union. Their purpose was to advance U.S. economic interests and to encourage parallel improvement in our overall relations with that country.

In July of the same year an agreement providing for the extension of $750 million in CCC credits to the Soviet Union over a three-year period was concluded.

In October the Maritime Agreement was reached opening 40 ports in each country to the flagships of the other and providing that U.S. and Soviet ships should share equally and substantially in the carriage of cargoes between the two countries.

Also in October, the Trade Agreement was concluded providing for reciprocal extension of most-favored-nation (MFN) tariff treatment, along with the Lend Lease Settlement, providing for Soviet payments of $48 million by July 1975 and of $674 million following U.S. extension of MFN tariff treatment.

At the same time the President issued a national interest determination authorizing the extension of Eximbank facilities to the U.S.S.R.

In Eastern Europe, the Administration acted to improve trade and economic relations with Romania and Poland. Eximbank facilities were restored to Romania in November 1971 and to Poland a year later.

Following passage of the Equal Export Opportunity Act in 1972, U.S. strategic export controls were reduced to bring the list of controlled items into closer conformity with the list of items controlled by our COCOM allies.

These developments were generally successful in advancing U.S. economic interests in East-West trade. The flow of goods and an exchange of people between our country and the East increased at an extraordinary rate. Our commercial presence expanded in Moscow, Warsaw and Bucharest as U.S. firms established permanent representations there. The U.S. trade surplus with these countries grew significantly, totalling more than $2.5 billion with the U.S.S.R. alone during the 1971-76 period, and $3 billion with Eastern Europe.

U.S. Impediments to Greater East-West Economic Cooperation

Following adoption of the Trade Act in January 1975, including those provisions which adversely affect our trade with the U.S.S.R. and most of Eastern Europe, further improvement in our commercial and economic ties became harder to achieve. The U.S.-Soviet Trade Agreement was not entered into force, and the Lend Lease payments were suspended. The momentum slowed, costing our economy exports and jobs in our export industries.

These provisions of the Trade Act hinder the development of United States economic activity with the East by blocking the financing of American exports by agencies of the United States Government, and by preventing most-favored-nation treatment of imports from most of the nonmarket economy countries.

President Ford and other members of this Administration made clear our opposition to the discriminatory provisions at the time the trade legislation was under consideration in the Congress. After the legislation was passed, President Ford publicly and emphatically stated his belief that remedial legislation was urgently needed.

Section 402 and related provisions of the Trade Act, and the 1974 Eximbank Act Amendments, have adversely affected the expansion of U.S. economic cooperation with the East, and have served neither the political nor the humanitarian interests of the United States.

A solution to the legislative problem would materially enhance our business community's efforts to expand economic relations with the East. We have had many indications that the lack of official credits from the U.S. has caused the U.S.S.R. and some of the Eastern European countries to direct their purchases elsewhere. Lost U.S. exports has meant lost jobs in our export industries, a negative impact on our balance-of-trade and on our competitive position in world markets.

The inability to extend MFN treatment to imports from Eastern countries has also held back important forms of economic cooperation, such as major joint projects between our firms and the U.S.S.R. and countries of Eastern Europe. This is because these projects often involve the eventual export of products to the U.S. that are now affected by U.S. non-MFN tariffs. Such projects, especially with the Soviet Union, could eventually supply the United States with products in limited supply in our own market, such as energy sources and products from energy consuming projects. Losing these major joint projects is, therefore, a net loss to the U.S.

On November 30, Secretary Simon and I visited Moscow to attend the third annual session of the U.S.-U.S.S.R. Trade and Economic Council with Foreign Trade Minister Patolichev. We experienced again, at first hand, the American business community's strong belief that existing U.S. law has strongly impaired the development of our economic and commercial contacts with the Soviet Union.

Based on our discussions, we continue to believe that intensified economic relationships build a community of interest which can create an environment for progress on political issues.

As the Soviet and American leadership have developed the spirit of detente it has moved forward on a diverse set of fronts -- political relationships, military concerns, scientific developments, trade and economic cooperation and many others. Each of these parts is related. We should strive to move them forward in a manner that is self-reinforcing.

Detente must not be seen as a short-term tactic but rather as a sustained and growing commitment on both sides. While recognizing the differences between our political and social systems, we must work at a broader definition of detente, one which promotes increased understanding and concern for the complex of issues -- security, humanitarian and economic -- that form the interface of our relationship. Within this relationship our economic interests have become a critical element, a significant shift from the early 1960's when they were barely perceived in and of themselves, at all.

If we are to build a stronger foundation for economic cooperation with the countries of the East that will foster mutual benefits, the new Administration must work with the new Congress in the months ahead to pass remedial legislation that will remove existing impediments.

I believe that such a legislative effort should be of the highest priority. It is also important to understand, however, that progress on the humanitarian issues is of deep concern to the American people, and that the way in which this concern is satisfied will affect the success of any legislative proposal.

The Basket II text on trade stresses efforts by states to promote trade and to remove obstacles to trade development. While this section provides no firm standard of conduct because the provisions are couched in general language, the Agreement nevertheless states that signatories "will endeavor to reduce or progressively eliminate all kinds of obstacles to the development of trade."

It is my belief that remedying the problem of the discriminatory provisions in existing law will further the economic and political interests of the United States, and such action would also be consistent with the Helsinki Final Act.

In addition we must encourage another change in U.S. law that would remove an unnecessary barrier to the expansion of U.S. commercial relations with the nonmarket economies of the East. The Johnson Debt Default Act of 1934 provides criminal penalties for any individual who, within the U.S., purchases or sells bonds or any other financial obligations of any foreign government which is in default in the payment of its obligations to the United States. The Act has not served its initial purpose, which was to protect American investors against the purchase of obligations of countries likely to default. Instead, it has had the effect of deterring creative methods of financing East-West economic activity by the private market. The repeal of the Act would, in my opinion, facilitate the expansion of this trade on commercial terms.

With regard to our antidumping and countervailing duty legislation, some of our nonmarket trading partners have expressed their concern that these may unfairly hinder their ability to export to the United States. In fact, the application of the antidumping and countervailing duty statutes to exports from nonmarket economy countries may provide too much protection. These remedies are based on market-economy concepts, and their application to goods produced in state-controlled economies requires somewhat arbitrary and artificial comparisons of prices and costs. While I have no specific recommendations at this time, consideration should be given to substituting market-disruption remedies for antidumping or countervailing duties.

Eastern Impediments to Greater East-West Economic Cooperation

While the United States must strive to remove obstacles to implementation of the goals of Basket II of the Final Act, the nonmarket economy countries must undertake parallel efforts.

For instance, the Soviets and East Europeans can do much to facilitate East-West economic cooperation by improving the physical facilities available to Western businessmen in these countries. A basic limiting factor in improving business facilities in these countries is the shortage of adequate physical resources -- office space, telephones, telex service, good secretarial help, and living quarters. Often there is not enough office space for all who desire it. Several countries, including the Soviet Union, are taking steps to provide better facilities, through construction of modern hotels and office buildings dedicated to the service of foreign businessmen. But much remains to be done.

There are presently over ten U.S. firms awaiting accreditation by Soviet authorities to establish permanent offices in Moscow, in addition to the 24 U.S. firms already established there. The Soviets have stated that, with regard to accredited offices, U.S. firms will receive treatment no less favorable than that accorded to companies of other countries. We are hopeful that accreditations will be forthcoming as the shortage of office and housing space improves.

Another area in which significant improvement is possible concerns the issuance of visas for American businessmen to enter and leave the Communist countries. The lack of multiple entry and exit visas for U.S. businessmen permanently stationed in the U.S.S.R. and other countries causes considerable hardship and psychological stress when they have to enter or exit quickly because of a personal emergency or commercial necessity. The Soviets have never accepted our long-standing proposal that all resident U.S.-citizen employees of accredited American companies receive multiple entry and exit visas in exchange for the issuance of multiple entry visas to all permanent Soviet personnel of Amtorg, the Kama Purchasing Commission, Intourist, and the Trade and Economic Council. (The U.S. has no exit visa requirements.) We have also stressed the need for such visas for third-country nationals assigned as heads of accredited offices. The Soviets have gone part way to meet our proposals, by granting multiple entry and exit visas to the two top-ranking U.S. representatives of U.S. commercial establishments, and the three ranking U.S. representatives on the Trade and Economic Council, but they have refused to issue such visas to third-country nationals representing U.S. firms in the U.S.S.R. This has caused considerable concern among some U.S. companies who wish to assign third-country nationals as their Moscow representatives.

The Soviets and East Europeans could also do much to further the goals of the Final Act by making available up-to-date economic and trade information on a regular basis. The Final Act provides that the Participating States will promote the publication and dissemination of economic and commercial information at regular intervals and as quickly as possible, particularly statistics concerning production, national income, budget, consumption and productivity, foreign trade statistics, laws and regulations concerning foreign trade, and information allowing forecasts of the development of the economy.

The provision of economic and commercial information, particularly of a nature that would be useful to Western business firms and banks, has not, with a few exceptions, improved greatly in the period since the Final Act was signed.

With respect to the Soviet Union, there have been no major changes since Helsinki in the quantity, quality, and timeliness of statistics and other economic and commercial information published within the Soviet Union. There have, however, been some small improvements. For example the publication of quarterly trade statistics by country and the provision to the United States bilaterally, under the U.S.-U.S.S.R. Agricultural Agreement, of better agricultural data.

The U.S.-U.S.S.R. Commercial Commission's Working Group of Experts, established under the Long-term Agreement between the United States and the U.S.S.R. to facilitate economic, industrial and technical cooperation, has also served as a productive mechanism for obtaining better statistics and other economic and commercial information from the U.S.S.R. This body is charged with exchanging information and forecasts of basic economic, industrial and commercial trends to facilitate economic cooperation between the U.S. and the U.S.S.R. We have made progress in obtaining more information through the Working Group's information exchange program and in special seminars on Market Research and on the organizational and legal aspects of U.S. and Soviet foreign trade.

Provision of statistics concerning production, national income, budget, consumption, and productivity from most of the nonmarket economy countries continues to be largely unsatisfactory, however, and no significant change has been evident in the manner of reporting these statistics since Helsinki. Balance-of-payments statistics are especially meager. Little data on debt, debt service, or reserves are published.

Although the traditional Eastern European and Soviet secrecy with regard to basic economic data is slowly eroding, in many Communist countries, market research information is simply not available of the kind Western businessmen are used to having. Such information is not gathered, much less published. In solving this problem, the provisions of Basket II amount to a nudge in the right direction, with a long way to go.

Another major area for improvement in East-West economic cooperation is with respect to joint ventures and other forms of industrial cooperation. The Final Act aims at cooperation in such fields as manufacturing, exploitation of energy resources, and improvement of transport. The Participating States propose to encourage this by means of intergovernmental agreements, both bilateral and multilateral, and through contracts between enterprises and trade organizations. These would include joint production and sale, exchange of knowhow patents, and licenses, and joint research, as well as cooperation on standardization and arbitration.

Considerable progress had already been made in these areas before Helsinki, and forward movement has continued since then, including the recent conclusion by the United States of a long-term agreement with Romania on economic, industrial and technical cooperation. However, major impediments remain which the Soviets and East Europeans could help resolve.

American businessmen report that Soviet procedures make it difficult, slow, and costly to do business with them, requiring much patience and skill. One of the most frequently heard comments is that Soviet requests for proposals are not specific enough; in effect they ask the vendors to tell them what they need. This forces the companies to do an excessive amount of design work before preparing their tenders. American companies spend millions of dollars repeatedly preparing bids, and most complain that the whole concept and scope of work of the projects keep changing, wasting time and money.

U.S. executives have also pointed out that the unwillingness of the U.S.S.R. to allow foreign managers a role in projects after completion is hurting the prospects for joint business efforts. Thus, U.S. hotel firms will not allow their name on a hotel unless they have a management role. U.S. firms also wish to have a role in quality control of a manufactured product if their name is to be associated with it.

Some of the East European countries have opened the possibility of equity participation and management responsibility in joint enterprises, notably Romania, Hungary and

Poland. While this development is very encouraging, the exact terms of such participation are often unclear and subject to interpretation. We applaud what has been done, but the clarification of such questions is an area in which more progress can be made.

Existing Bodies Which Facilitate Economic Cooperation

As you are aware, non-government and governmental bodies are now in existence whose purpose is to help remove many of these obstacles to the expansion of East-West economic cooperation. I am speaking here of the joint councils, whose membership consists of U.S. businessmen and their counterparts in many of the countries of Eastern Europe and in the Soviet Union, and the government-to-government commercial commissions.

U.S.-U.S.S.R. Trade and Economic Council

In my contacts with the U.S.-U.S.S.R. Trade and Economic Council, I have been impressed by the important role this private organization has played in strengthening economic ties between the United States and the Soviet Union. The Council's unique contribution in providing continuing access for U.S. businessmen to Soviet foreign trade policy makers at a time when American-Soviet governmental relations in the economic sphere have been strained by the legislative situation, and also by the repercussions of recent political developments, is important for the further development of U.S.-Soviet economic cooperation.

In the three years since its creation in 1973, the Council has worked to bring together businessmen, offering a wide variety of services to facilitate their activities, and organizing expositions, conferences, and seminars. In Moscow the Council has offered office facilities to its hundreds of American members, and has helped them with advice and information on doing business with Soviet organizations. It has explored new forms of international business cooperation and provided a forum for resolution of problems and the discussion of new ideas.

The Council has established several committees for the specialized programs it hopes to implement. Its Science and Technology Committee is sponsoring a series of seminars both in the U.S. and U.S.S.R., the most recent one being on coal gasification in Moscow in early October. The Finance Committee plans to inventory non-government sources of export financing and recommend steps to increase the amount of financing available from investment banks, insurance companies, and regional banks. The Ad Hoc Committee on New Forms of Cooperation is exploring such matters as joint ventures in third countries, marketing training for Soviets in the U.S., establishment of a bonded warehouse in Moscow for storage of spare parts and for servicing of equipment, and Soviet leasing of plants for 15-20 years as a way of maintaining Western management involvement within Soviet legal restrictions. The Tourism Committee is trying to facilitate and increase tourism in both directions and is working out a tourism agreement which it plans to present to the two governments for them to negotiate. The Legal Committee is seeking to identify and publicize differences in the American and Soviet commercial legal systems and to reduce the extent to which these differences hamper the development of trade. All these committees met during the recent Council meeting I attended.

U.S.-U.S.S.R. Joint Commercial Commission

I have also been directly involved in the activities of the Joint U.S.-U.S.S.R. Commercial Commission, which was established during the Moscow summit of May 1972. The Commission's purpose is to promote the development of mutually beneficial commercial relations between the United States and the Soviet Union.

The accomplishments of the fifth and most recent session of the Commercial Commission, held in Moscow in April 1975, serve as an excellent example of the work being done under its auspices. The session covered the full range of issues important to the expansion of bilateral economic relations.

During the two-day session in Moscow, the members of the Commercial Commission heard reports and exchanged views on the status of discussions between Soviet foreign trade organizations and U.S. companies on a number of cooperation projects, including exploration for oil and gas, machine-building, and the manufacture of energy-consuming products. The facilitation of visa issuance, including multiple entry-exit visas to representatives of organizations, enterprises and firms for business-oriented travel, was also discussed.

The Joint Commercial Commission has two Working Groups which met during the Fifth Session. The Working Group on Business Facilitation met to discuss various topics, among them the establishment of joint U.S.-U.S.S.R. stock companies, visas and travel facilitation, marine cargo insurance, and a bilateral air worthiness agreement.

The Working Group on Major Projects and Financing discussed the status of several bilateral projects including the Occidental Petroleum Chemical Complex and the Kama Truck Plant.

The Commission also heard a report on the first meeting of its Experts Working Group, held in February 1975, in Moscow. At that meeting, presentations were made by both sides on the performance and prospects of their respective economies, industries, agriculture, foreign trade, and on the data sources used to measure and analyze their trends and forecasts. In addition, the Working Group agreed to undertake a specific program of information exchange for calendar year 1976, to include joint seminars and periodic data exchanges which helped clarify and facilitate solutions to many practical problems encountered by our businessmen as they undertake economic cooperation with the Soviet Union.

In short, Mr. Chairman, the Trade and Economic Council, the Joint Commercial Commission and Experts Working Group have been important vehicles for promoting greater East-West economic cooperation and have thereby served U.S. policy interests in East-West relations.

Because of their usefulness, I believe that the new Administration should soon propose to the Soviets a new date for meetings of the Experts Group and the Joint Commission. These invitations must be made by our Government because it is our turn to serve as host for the meetings. I am confident that the Soviet Government will welcome such initiatives.

Conclusion

Mr. Chairman, I have attempted to be as forthright and as frank as possible in providing you the highlights of those activities and efforts undertaken by this Administration, and which should be taken by the new Administration, to expand East-West economic cooperation in keeping with the terms of Basket II of the Final Act. I have also outlined those areas in which we should look for positive movements by the nonmarket economy countries which are signatories to the Helsinki Agreement.

It is an opportunity that I personally have welcomed. Basket II of the Final Act provides countries in the East and West with a foundation on which they can build stronger ties through closer economic, scientific and technical cooperation. My experience as Assistant Secretary of the Treasury has convinced me that these ties are vital for the long-lasting peaceful relations we all seek.

As this Commission works in the future for further implementation of the provisions of Basket II of the Helsinki Agreement, I urge you to continue to strive for measures that will remove obstacles to the expansion of East-West trade.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: L.F. Potts
Extension 2951
January 14, 1977

FOR IMMEDIATE RELEASE

SIMULTANEOUS WITHHOLDING OF APPRAISEMENT AND DETERMINATION OF SALES AT LESS THAN FAIR VALUE WITH RESPECT TO CLEAR SHEET GLASS FROM ROMANIA

Under Secretary of the Treasury Jerry Thomas announced today a three-month withholding of appraisement and simultaneous determination of sales at less than fair value with respect to clear sheet glass from Romania. Notice of both these actions will appear in the Federal Register of January 17, 1977.

The case has been 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 injury determination, dumping duties will be assessed on all entries of the subject merchandise on which such affirmative determination is made and where dumping margins exist.

No request for a 6-month withholding of appraisement having been received, known interested persons were afforded the opportunity to present oral and written views prior to these determinations.

Imports of the subject merchandise from Romania during the period January through September 1976 were valued at roughly $3.2 million.

* * *

WS-1262

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

January 14, 1977
Contact: Jay Scheck
566-5561

CHANGE IN TAX REGULATIONS DEFINING PARTNERSHIPS NO LONGER TO BE CONSIDERED

Secretary of the Treasury William E. Simon announced today that the Department of the Treasury is no longer considering a proposed amended regulation classifying organizations, including the defining of partnerships, for purposes of federal taxation.

In a statement on the subject, the Secretary said: "On January 6, 1977, in order to permit consideration of certain aspects of the proposed amended regulations classifying organizations for purposes of federal taxation, I directed withdrawal of those proposed regulations. Having now considered the matter further, I have concluded that the amendment should not be reproposed.

"The existing regulations on the subject will remain in force, and the Internal Revenue Service will be able to continue its past practice of issuing rulings pursuant to those regulations."

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WS-1263

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041
THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE

January 17, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,402 million of 13-week Treasury bills and for $3,510 million of 26-week Treasury bills, both series to be issued on January 20, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 21, 1977			26-week bills maturing July 21, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.828 a/	4.636%	4.76%	97.545 b/	4.856%	5.05%
Low	98.818	4.676%	4.80%	97.537	4.872%	5.06%
Average	98.820	4.668%	4.79%	97.539	4.868%	5.06%

Excepting 1 tender of $750,000
Excepting 1 tender of $10,000,000

Tenders at the low price for the 13-week bills were allotted 22%.
Tenders at the low price for the 26-week bills were allotted 55%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 39,370,000	$ 19,870,000	$ 50,215,000	$ 28,715,000
New York	3,873,840,000	2,148,740,000	6,491,705,000	3,283,360,000
Philadelphia	19,185,000	17,780,000	105,190,000	5,190,000
Cleveland	32,305,000	31,500,000	138,275,000	9,275,000
Richmond	26,340,000	14,740,000	95,835,000	49,085,000
Atlanta	20,850,000	19,570,000	63,870,000	9,260,000
Chicago	260,370,000	40,410,000	294,960,000	58,260,000
St. Louis	48,110,000	22,440,000	43,025,000	13,130,000
Minneapolis	13,340,000	7,340,000	21,385,000	3,385,000
Kansas City	40,595,000	34,825,000	16,955,000	12,955,000
Dallas	19,335,000	14,335,000	37,265,000	13,265,000
San Francisco	355,555,000	30,570,000	447,520,000	24,020,000
Treasury	75,000	75,000	95,000	95,000
TOTALS	$4,749,270,000	$2,402,195,000 c/	$7,806,295,000	$3,509,995,000 d/

Includes $313,625,000 noncompetitive tenders from the public.
Includes $128,580,000 noncompetitive tenders from the public.
Equivalent coupon-issue yield.

1264

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

REMARKS BY TREASURY SECRETARY-DESIGNATE W. MICHEAL BLUMENTHAL
DETROIT ECONOMIC CLUB
COBO HALL, JANUARY 17, 1977

When I accepted the invitation to speak today, I planned to discuss the Michigan Economic Action Council. Since then, circumstances have changed somewhat and so I have a few other things to say as well.

I am not here to say good-bye. My family and I have roots in Michigan, we're not really going to pull them up -- we're just going to stretch them a bit. But going to Washington, as challenging and exciting as the opportunity is, does mean that we won't be seeing many of you quite as frequently as before, I won't be working with you -- at least not in the same way -- on MEAC and other projects, and I will be seperated from my colleagues at Bendix.

I was pleased to be introduced by Bill Agee. I only hope that some of my other new colleagues in Washington will leave their old jobs in private life feeling even half as confident about their successors as I feel about mine.

It is reassuring to know that Bendix will be in the hands of a man like Bill Agee. And I say that not only for what Bendix means to me, but for what it and other healthy, growing businesses in Michigan mean to the goal of moving this State in significant new directions.

When I accepted the chairmanship of MEAC, I did so for the same reasons so many distinguished and influential Michigan leaders agreed to serve: we could see the compelling need to soften the roller coaster ride the Michigan economy suffers because of our exaggerated sensitivity to national business cycles.

Today I want to make a comment about the spirit of MEAC. I mean the quality of responsiveness, cooperation and common commitment which many organizations strive for and few attain.

It began with the Governor, the Speaker and the Majority Leader rising above their partisan differences to advance the best interests of all the people of this State. That spirit of unity spread -- we had business leaders and labor leaders, we had academicians, urbanites and farmers, media people and money people, representatives from the tourist and recreational industry, all moving together, working together -- in this case to improve our economy.

Working together we achieved unanimous agreement on twenty-four recommendations as to things we can do to provide stable long-term growth in our State economy. I urge you to work for the implementation of those recommendation to keep them going. I want to highlight two specific points which I think are the most significant.

First is the Budget Stabilization Fund which we have proposed as a leveling device to help counter fluctuations in State revenues. As you know, Michigan's Constitution obligates the State to maintain a balanced budget. Its principal source of revenue is the State income tax, of course, and when we have an economic downturn, our revenues drop, and simultaneously the demand for human services programs goes up.

The proposed Stabilization Fund would put aside a portion of its revenues during years when personal incomes are high and unemployment low and then to spend that money during years of recession. This would require fairly rigid formulas and controls over the process and these are reflected in the bills being introduced now into the legislature. Of all the recommendations of MEAC, I think that this one represents the best hope for easing the exaggerated swings in the Michigan business cycle and their effects on State revenues.

The second recommendation I would highlight is that of diversifying the economic base of the State. MEAC agreed that there are two specific kinds of employers which should be attracted to create new jobs: service industries not dependent on a specific geographic location, and high-technology, fast-growth industries. Michigan has been getting some high-technology industry, but we haven't begun to realize our potential. The Council specified a series of actions which the State could take, both through its industrial expansion programs and its other policies, such as business taxation, that would make Michigan an even more attractive location to such employers as, for instance, the regional offices of insurance companies. These are the types of businesses we -- or rather, you -- must work to bring to Michigan.

The Council also recommended programs to help with the financing and advising of small, entrepreneurial business, in particular those with a high technological orientation. Such industries often have a high mortality rate because of lack of business experience. So the Council made a series of recommendations on how to increase the efficiency and size of the venture capital market for Michigan industries and on how to create or improve existing programs of assistance to small business.

I want to make it clear that I have not singled out these two subjects because I think the other recommendations of the Council are unimportant. To the contrary, I think that they should all be vigorously pursued.

I had hoped and expected to take an active hand in the effort to follow through on these ideas. My intention, in fact, was not only to urge you and other people in the State to work for their implementation, but also to spend as much time as I could in Lansing myself on the Council's business. Mow, of course, that is no longer possible, - you might say because of a funny thing happened to me on the way to Lansing! - In washington, naturally, I find myself looking at Michigan's economic problems, and indeed at the nation's economic problems, from an entirely different perspective.

There is some irony in this situation, because we made a great point, during our MEAC deliberations, of concentrating on recommendations which could be implemented at the State level and still have a real impact on the problems we were trying to address. We were very much aware that there are limits to local action and that the crucial decisions affecting our economy would be made on the federal level, but we determined to focus on what we could do on our own. We felt that this was in the American tradition of self-help and we knew that one more voice added to the chorus in Washington would have less chance of being heard than if the message were delivered directly to Lansing.

Now, however, I find myself in the unexpected position of addressing precisely those problems which we deliberately ruled out of our MEAC deliberations, -- because they involved action on the Federal level. To paraphrase Pogo, I can now say that I have met the enemy - and it is I.

Such a change of perspective can be disconcerting, but I must say that the spirit of our work in the Michigan Economic Action Council is very happily alive in the team we have been putting together in Washington. Governor Carter is deeply committed to an open government, a government in which decisions are made in an atmosphere of cooperation and communication, not of secrecy. This is a philosophy and an approach which I find personally congenial, -- but it is one which in the past, I fear, has only too rarely been found among senior government officials. Whatever else we achieve -- and we are well aware of the difficulty of the tasks before us -- we now have an opportunity for a new beginning, under a President who believes that government must find its way back to the kind of participation and cooperation we had in the Michigan Economic Action Council.

As an example, I should tell you that I will leave here this afternoon and go to visit the local facilities of the Treasury in Detroit. I want to meet the Treasury people there, get to know them and give them access to me. I am told that this is the first time a Secretary of the Treasury has ever gone to visit these installations, and I think it's time that we put an end to that kind of isolation. It will be a hallmark of the Carter Administration to try to break out of the sometimes artificial isolation of Washington. I will begin the process in the Treasury Department this afternoon, and my colleagues will continue it along with me during the rest of this Administration.

At the same time, there will be greater stress on increasing the efficiency and effectiveness of government, goals which are a natural outgrowth of the closer communication we are seeking. There is no law which says that government must be slow moving and unresponsive -- anymore than there is a law which says that it must be inaccessible. Americans in government are in no way inherently less efficient than those who work in private industry. They are certainly no less capable of doing a good job and being proud of their work. We must ensure that the environment in which they work allows them to find a reward, to develop a sense of pride and to avoid burying their efforts in a bureaucratic morass in which no one believes.

Along with these Carter Administration goals of openness and efficiency, there is another: we intend to be practical. We propose to take initiatives which are responsible, measured and gradual in their impact. While they may be bold in concept, they will be careful in execution. And they will not be oversold.

We will not pretend to have a miracle cure in our quest for a healthy diet leading to eventual full recovery. The new Administration is acutely conscious of the need not to raise false hopes, and not to indulge in hyperbolic descriptions of what can be done in a brief period of time. We will make changes and we will move forward, but our country's problems are deep and long-standing and -- since openness also implies frankness and truth -- we will not pretend that they can be solved overnight or that we will not have difficult choices to make.

So, I have no hesitation in defining the spirit in which we begin our work. We want to be open. We want to be efficient. We want to proceed pragmatically and with care. And we want to be truthful about our failures, as well as our successes. But what about our agenda? Since Governor Carter has not yet become President Carter it is perhaps a little early to attempt to answer that question precisely, - but - if I may confine myself to the problems of the economy -- I think the President-elect's priorities, and the outlines of his program, are clear.

To begin with, we need growth. "Growth with stability." This is the formula we used in Michigan and it can be applied just as aptly to the country as a whole. Our economy is recovering from the very severe recession of 1974-1975, but it is recovering too slowly. Output is rising again, but not fast enough. We need more jobs for a constantly expanding work force. We need more and better housing. But, the essential point is that we cannot begin to meet any of these needs adequately if our economy is not moving ahead and growing in a healthy way.

By healthy growth, of course, I mean growth without inflation. Nothing can be more damaging to our society than the high level of inflation such as we experienced in recent years, -- especially in 1973 and 1974. Such a rise in costs and prices distorts more than our business and financial operations. It leads eventually to dislocations. We believe that growth <u>can</u> take place without necessarily triggering inflation.

It can and it must, -- because the level of unemployment we have experienced in this country in recent years is intolerable. Nothing, it seems to me, can be more important, nothing is more urgent, than to provide employment for all those who are able and willing to work.

The problem with most discussions of unemployment is that they deal with statistics, -- statistics which often hide as much as they reveal. We say, for example that our goal is to lower the unemployment rate from the presently unacceptable level of 7.9 percent to more tolerable rates. As a measure, unemployment statistics are meaningful. But behind these numbers, which represent national averages, there is a social reality, -- and this is what we must grasp if we are to understand why the new Administration has identified unemployment as the most urgent problem on the national agenda.

The social reality we must grasp can be illustrated by other numbers which are very different -- and much less abstract -- than the national average. We must realize, for example, that unemployment rates are higher for females than for males and also higher for non-whites than for whites across all age groups. We note, too, that unemployment for teenagers, both black and white, averages about 19 percent and that for black teenagers in the poverty areas of our cities, the unemployment rate is currently about 40 percent.

The situation we are dealing with, in other words, is not only tragic and socially dangerous -- it is also extremely complex. And this complexity means that not one but a variety of approaches is required.

So called macro-economics measures, for example, -- the kind which stimulate the economy generally across the board -- will be useful in reducing unemployment among trained, mature working people who are standing, so to speak, at "the head of the line" and are ready, willing and able to enter or re-enter the labor force.

Such measures may, indeed, have the effect of expanding total employment, -- and this, of course, is important and good. In our economy each percentage point of real growth in the GNP will provide something in the order of 500,000 jobs and, since it is the private sector which accounts for five out of six of these jobs, it is essential that we encourage the capital investment which makes the private sector grow.

So far so good, -- but far from good enough! This growth, unfortunately, will have little or no effect on those who are not standing at the head of the employment line, -- nor on certain regions, certain categories, certain age-groups, in short, on the so-called "hard-core." For these people a different approach is needed, -- one which aims not at the overall economy and its rate of growth but rather, specifically, at them -- as people.

To talk about unemployment in these terms, of course, inevitably invokes the plight of our cities. This is a larger subject which transcends merely economic terms, yet, the economic aspects of the so-called urban crisis -- middle class and blue collar flight from the city, tax base shrinking, essential services cut back, industry moving out, -- all add up to one statistic: unemployment for those who are left behind. It breeds despair, frustration and bitterness, -- and they in turn breed social decay and crime. These lead to increased public expenditures which have to be paid from increased taxes which accelerate the flight of the middle classes, so that we have the familiar downward spiral which affects so many of our great cities and threatens the quality of our civilization itself.

To begin to address these complex and interrelated issues, the President-elect has already proposed an economic stimulus package. It includes a variety of measures, such as a tax rebate and a permanent individual tax cut, programs to encourage corporate investment and others directly aimed at putting young people and the so-called hard-core unemployed to work.

No one believes that these programs offer a panacea. But they do represent a beginning, a carefully beginning, in what must be seen as a long and difficult task. In the spirit I attempted to define a few moments ago -- the spirit of initiatives and careful execution -- we must be prepared to monitor the various programs in our so-called stimulus program, and adjust them to changing conditions if necessary.

In the meantime, of course, we cannot forget that -- beyond the immediate need to accelerate our economic recovery additional programs will have to be developed. The problem of tax reform, in particular, is very high on our agenda. We, for example, are determined to find practical, effective ways to simplify the system. There is something very wrong, it seems to me, in the fact that a middle-income wage earner must hire an accountant in order to complete his tax return.

Tax reform also should address making the system more equitable. Another goal would be to help it stimulate growth by encouraging investment in the private sector. In a word, we believe that the American people should not be working for the tax system. The tax system should be working for them.

The steps we are taking to move the economy and strengthen the recovery will cost money, and we are keenly aware that the deficit we are inheriting from the previous Administration is excessively large. But the consensus over the broad spectrum of economists and businessmen is that under present conditions, with much under-utilized capacity in the economy, it is entirely possible to apply this stimulus without rekindling the flames of inflation. And we know that we cannot begin to do the nation's business, to meet our responsibilities domestically and internationally, -- nor hope to move forward balancing the federal budget in the foreseeable future -- unless our economy achieves and maintains a higher rate of growth.

Before concluding, let me refer briefly to the relationship of all this to the situation abroad. The slow recovery in the United States has been matched by an even more sluggish condition in Europe and Japan. This is a matter of concern to us because we are, increasingly, in a global economy, and economic weakness in one area inevitably affects all the others. Payments imbalances, weak currencies, lagging invesment programs, -- all these interreact in a global economic setting. They stifle trade and create unfavorable atmosphere for growth and for the solidarity we need if we are successfully to deal with our common problems.

We have assigned the highest priority to our domestic economic problems for a simple and obvious reason: our own house must be put in order if we are to properly play our role in the rest of the world.

Looking back over the past decade or so it seems to me that somewhere, somehow, our country lost its way. We have been too long off course, and historically, our recent election will be seen as the beginning of a national effort to recover our momentum and our sense of purpose. What matters is not merely that we have a new Administration. What matters is that we are turning to the future. We are making a new start.

That, at least, is our intention, -- and it is time to recall that we are still the greatest and richest country in the world and that we have the power to make good on the promise we still represent -- the promise of peace and justice and a better life for the common man -- which we still represent in the eyes of the world

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Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

For Immediate Release January 18, 1977

TREASURY PUBLISHES "BLUEPRINTS FOR BASIC TAX REFORM"

Secretary of the Treasury William E. Simon today released results of a year-long study of fundamental reform of the Nation's tax system.

The report, "Blueprints for Basic Tax Reform," presents two model plans for tax returns: a broadly based income tax, called a "comprehensive income tax," and an alternative plan for a tax based on consumption, called a "cash flow tax." Either plan would be much simpler, fairer, and more efficient than the present system.

"Tinkering is no longer the answer," Simon said in the foreword of the report. "We must design an entirely new tax system, adopt it as an integrated whole, with a much broader tax base but with much lower and simpler rates so that it will be widely accepted and so that all can share its advantages."

Both reform proposals would broaden the tax base, reduce tax rates, and allow larger personal exemption. The comprehensive income tax plan calls for integration of the corporate and personal income taxes, taxation of capital gains at full rates after allowing an adjustment for inflation, and taxing many other items that presently are not taxed. In place of the existing complex rate structure, with rates ranging from 14 to 70 percent, the model plan has only three rate brackets, ranging from 8 percent to 30 percent.

The cash flow tax differs from an income tax in excluding savings, although the withdrawal of savings for consumption of goods and services would be taxed. This model also has three tax brackets with rates from 10 to 40 percent. Because the present income tax system has many important similarities to the cash flow tax, the change to this model would not be as great as it might seem.

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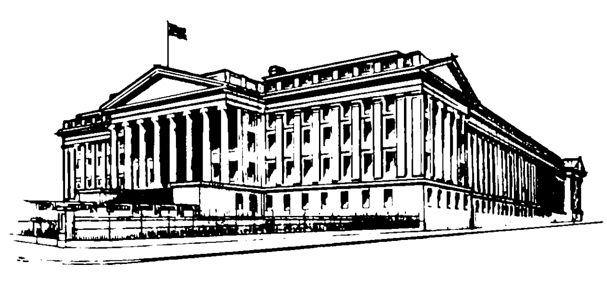
blueprints for Basic Tax Reform

January 17, 1977

blueprints for Basic Tax Reform



January 17, 1977

Department of the Treasury

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

FOREWORD

In December 1975, in a speech to the Tax Foundation, I called for a fundamental overhaul of the U.S. tax system. I felt that I was speaking for millions of Americans who were fed up with the current tax system and wanted it replaced with one they could understand and trust. I noted that we need to return to the basic principles upon which our income tax system was founded and the three cornerstones of its structure -- equity, efficiency and simplicity. I said we need to wipe the slate clean of personal tax preferences, special deductions and credits, exclusions from income and the like, and impose a single, simple progressive tax on all individuals. In the months that have passed since that speech, I have received overwhelming evidence that this is indeed the way the American people feel.

It is time to start over from scratch and develop a new tax system in the United States. It must be a system that is designed on purpose, based on a clear and consistent set of principles, which everyone in the United States can understand.

During the past year, at the same time my staff and I were working with the Congress on the Tax Reform Act of 1976, we were also engaged in a major study, which we called the "Basic Tax Reform" study. We began by examining the concept of "income" and what it can and should mean as the base for Federal taxation. We looked at all the transactions and circumstances that produce what we commonly think of as "income," and we also considered "income" from the standpoint of its uses -- its value to those receiving it.

We then tried to develop an ideal income base that took into account all possible forms of income but that equally considered practical realities and the overriding importance of a simple tax system. Our "real-world" implementation reflects many compromises and modifications that we have discussed explicitly in the study so that everyone can evaluate our judgments and our conclusions.

Our report -- Blueprints for Basic Tax Reform -- presents the results of this year-long study. It gets down to the fundamentals.

This report presents two specific model tax systems. The first is a plan for broadening the base of the income tax. It calls for integration of the corporate and personal income taxes, taxation of capital gains at full rates after allowing an adjustment for inflation, and taxing many other items that presently are not taxed. In place of the existing complex rate structure, with rates ranging from 14 to 70 percent, the model plan has only three rate brackets, ranging from 8 percent to 38 percent.

The second model is based on consumption and is called a cash flow tax. It differs from an income tax in excluding savings, although the withdrawal of savings for consumption of goods and services would be taxed. This model also has three tax brackets with rates from 10 to 40 percent. Because the present income tax system has many important similarities to the cash flow tax, the change to this model would not be as great as it might seem.

After years of seeking to reform the tax system, I am convinced that tinkering is no longer the answer. We must design an entirely new tax system , adopt it as an integrated whole, with a much broader tax base but with much lower and simpler rates so that it will be widely accepted and so that all can share its advantages. This report is a start toward this objective. It demonstrates clearly that we can construct a fair, efficient progressive tax system in the United States.

Responsibility for preparation of this study was taken by Assistant Secretary for Tax Policy Charles M. Walker. Deputy Assistant Secretary William M. Goldstein provided important counsel. Primary work on this project was undertaken by Deputy Assistant Secretary David F. Bradford. Mr. Bradford and the staff of the Office of Tax Analysis are due special recognition for their professional expertise and special thanks for their devotion to this task.

William E. Simon

Washington, D.C.
January 1977

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

ACKNOWLEDGMENTS

It is hard to imagine a project more appealing to a public finance economist than directing the professional staff of the United States Department of the Treasury in a study of income tax reform. A year ago Secretary William E. Simon asked Assistant Secretary Charles M. Walker to prepare a plan to simplify the tax system. As Deputy Assistant Secretary and Director of the Office of Tax Analysis, I was asked to lead this effort. With the publication of "Blueprints for Basic Tax Reform," the main objective of the project is accomplished, and it is my pleasure now to acknowledge the superb efforts of those who did so much of the work. The pages of the report are the product of a tremendous cooperative effort, much of it applied during evenings and weekends, by many dedicated people.

An especially important role was played by Harvey Galper, Associate Director of the Office of Tax Analysis. His experience and acumen as a tax analyst contributed directly to the project and his sense of humor and enormous capacity for work contributed indirectly by ensuring the smooth functioning of the Office. It was a delight to work with him.

Other principal associates in drafting the report were Larry L. Dildine and Eric J. Toder of the Office of Tax Analysis and Charles M. Whedbee, on loan from the Internal Revenue Service. Their analytical skills are reflected throughout the report.

Nelson McClung took principal responsibility for assembling the data base for the study, supported by J. Scott Turner, with Roy Wyscarver manning the computer simulations. Gary Robbins kept the project moving toward a sequence of unmeetable deadlines. Ron Garbin and the Office of Computer Science, Office of the Secretary, provided programming support.

The early groundwork for the study was developed with the assistance of Seymour Fiekowsky, Nelson McClung, Hudson Milner, and Ralph Bristol of the Office of Tax Analysis, and Richard Koffey, now Deputy Tax Legislative Counsel.

Many others, inside and outside the Department of the Treasury, contributed to the work. These include Peter Cook, John Copeland, Daniel Feenberg, David Flynn, Geraldine Gerardi, Gary Hufbauer, Michael Kaufman, Thomas King, Allen Lerman, Howard Nester, Gabriel Rudney, Jay Scheck, Eugene Steuerle, Walter Stromquist, and John Wilman, all members of the Office of Tax Policy Staff. Joseph Foote of Washington, D.C., Peter Mieszkowski of the University of Houston, Harvey Rosen of Princeton University, Richard Barr of Southern Methodist University, and Ann Bergsman of Hendrickson Corporation brought their special knowledge to bear on the problems we confronted. Others outside the Treasury who assisted in various ways include William Andrews, Martin Bailey, Edwin Cohen, Martin Feldstein, Frederic Hickman, Daniel Halperin, Bernard Saffran, Emil Sunley, Nicholas Tideman, and Alvin Warren.

Finally, for their unsurpassed skill, never ending patience and cheerfulness, deepest thanks to Rosalind Carter and Kathi Cambell who typed and typed and typed and ....

David F. Bradford

David F. Bradford
Deputy Assistant Secretary
for Tax Policy (Tax Analysis)

Washington, D.C.
January 1977

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BLUEPRINTS FOR BASIC TAX REFORM

Chapter 1

INTRODUCTION AND SUMMARY

OVERVIEW

There has been increasingly widespread dissatisfaction in the United States with the Federal tax system. Numerous special features of the current law, adopted over the years, have led to extreme complexity and have raised questions about the law's basic fairness. Many provisions of the code are, in effect, subsidies to certain types of taxpayers, or to particular interests, for some forms of investment and consumption. These subsidies are rarely justified explicitly and, in some cases, may even, be unintentional. In many instances, they alter the pattern of economic activity in ways that lower the value of total economic output. Further, although the Federal tax system by and large relates tax burdens to individual ability to pay, the tax code does not reflect any consistent philosophy about the objectives of the system.

Previous efforts at tax reform have not attempted a thorough rethinking of the entire tax structure. As a result, reform legislation over the past 25 years has consisted of a series of patchwork palliatives, leading to a tax system increasingly difficult to understand. Indeed, the Tax Reform Act of 1969 has been referred to as the "Lawyers and Accountants Relief Act," and the Tax Reform Act of 1976 deserves this sobriquet no less. The confusion and complexity in the tax code have led Secretary of the Treasury William E. Simon to suggest that the Nation should "have a tax system which looks like someone designed it on purpose."

The first part of this report is devoted to clarifying the goals of the tax system, attempting to give specific content to the universally recognized objectives of equity, efficiency, and simplicity. Based on this analysis, two alternative conceptions of an ideal tax system are adopted to form the basis for practical reform plans. The report presents two model plans, comprehending both the individual and corporate income taxes, which demonstrate that the tax system <u>can</u> be made more equitable, easier to understand and justify, and more conducive to the efficient operation of the private economy.

Both plans have the general effect of broadening the tax base -- the measure of income to which personal exemptions and tax rates are applied. This, is the result of including in the base items excluded from tax under current law. This permits a simpler code in that elaborate rules are no longer required for defining items of tax preference or for protecting against the abuse of such preferences. Under either plan, the revenues currently collected from individual and corporate taxpayers could be raised with a substantially lower rate structure. In turn a lower rate structure would mitigate the distorting effects of taxes on economic decisions.

The alternative proposals for tax reform are: (1) a comprehensive income tax, and (2) a consumption base tax, called a cash flow tax. Both proposals seek to treat individual items in the tax code in ways that would achieve consistency with an ideal base, departing from the ideal only when necessary for administrative feasibility, simplicity, or compelling economic or other policy reasons. When concessions are suggested, they are identified as such and justification is provided.

The differences between the proposals derive from their underlying concepts of the tax base. The comprehensive income tax proposal is based on a broad concept of income that is defined in terms of the uses of an individual's receipts. According to this definition, an individual's income can be allocated either to consumption or to increasing his wealth (net worth). Because all increments to wealth constitute income, this approach is sometimes called an accretion concept. The cash flow tax assesses tax burdens on the basis of consumption, excluding from the tax base all positive and negative changes in net worth.

Both proposals deal with the major areas in which changes from the current tax code merit consideration. In all cases where there are ambiguities about defining consumption or change in net worth as components of income, or where the benefits achieved by exclusions or deductions from income under the current law appear to merit continued consideration, specific policy judgments are made for the purpose of presenting complete proposals. The report identifies the features of each proposal that are essential to the definition of the ideal tax base, distinguishing them from elements that can be handled differently and still remain consistent with a reasonable definition of either the comprehensive income or consumption tax base. The table at the end of this chapter compares the major features of the model tax reform plans with the current tax system.

This study shows that it is feasible to have a broadly based tax that departs in major ways from the current tax law. In providing specific alternative plans, the report sets out a guide for future legislation aimed at sweeping tax reform. It also points out some of the major policy issues that remain to be resolved. In presenting a plan for a tax system based on the consumption concept, the report points toward a promising alternative approach to tax reform that is not as different from our present system as it might seem and that, if consistently implemented, should provide major advantages in fairness, simplicity, and economic efficiency.

COMPREHENSIVE INCOME TAX

Proposals to adopt a more comprehensive definition of income in the tax base have received the most attention from tax reform advocates.

As previously stated, income may be viewed as the sum of consumption and change in net worth in a given time period. Although income is thus defined conceptually in terms of uses of resources, it is not practical to measure an individual's annual income by adding up all of his individual purchases of consumer goods and the change in value of all the items on his balance sheet. Rather, the measurement of income is accomplished by using the accounting notion that the sum of receipts from all sources within a given time period must equal the sum of all uses. To compute income, it is necessary simply to subtract from sources expenditures that represent neither consumption nor additions to net worth. These expenditures include the cost of operating a business (payment of salaries, rent, interest, etc.), or the direct cost of earning labor income (union dues, work clothing, etc.). They may include other specified expenditures, such as interest, charitable contributions, State and local income and sales taxes, and large nondiscretionary medical expenditures.

Because of exclusions, deductions, and shortcomings in income measurement rules, the tax base under current law departs from this comprehensive concept of income. For example, State and local bond interest and one-half of realized capital gains are not included in the tax base. On the other hand, corporate dividends are included in the tax base twice, once at the corporate level and once at the individual level. In some cases, rules for tax depreciation allow deductions in excess of actual changes in asset values. When this occurs, business income is understated, and the taxpayer has increase in net worth that goes untaxed.

In setting out a practical plan to achieve equity, simplicity, and efficiency in the tax system, the model comprehensive income tax follows a broad concept of accretion income as a guide. The major features of the model comprehensive income tax are summarized below.

Integration of the Corporation and Individual Income Taxes

A separate tax on corporations is not consistent with an ideal comprehensive income tax base. Corporations do not "consume" or have a standard of living in the sense that individuals do; all corporate income ultimately can be accounted for either as consumption by individuals or as an increase in the value of claims of individuals who own corporate shares. Thus, corporations do not pay taxes in the sense of bearing the burden of taxation. People pay taxes, and corporate tax payments are drawn from resources belonging to people that would otherwise be available to them for present or future consumption.

It is difficult, however, to determine which people bear the burden of corporate tax payments. In a free enterprise system goods are not produced unless their prices will cover the costs of rewarding those who supply the services of labor and capital required in their output as well as any taxes imposed. The corporation income tax thus results in some combination of higher relative prices of the products of corporations and lower rewards to the providers of productive services, and it is in this way that the burden of the tax is determined. It spite of many attempts, economists have not succeeded in making reliable estimates of these effects, although a substantial body of opinion holds that the corporation income tax is born by all capital owners in the form of lower prices for the services of capital.

The two major advantages of integrating the corporate and personal taxes are that (1) it would eliminate the incentive to accumulate income within corporations by ending the double taxation of dividends, (2) it would enable the effective tax rate on income earned within corporations to be related to the circumstances of individual taxpayers.

Under the model comprehensive income tax, the integration of corporate income with the other income of shareholders is accomplished by providing rules to allocate all corporate income, whether distributed or not, to individual shareholders. Corporate distributions to shareholders are regarded simply as a change in the composition of investment portfolios -- that is, a portion of each shareholder's equity claims is converted to cash -- and have no tax consequences. Under this "full integration" plan, corporation income is fully taxed at the rates appropriate to each shareholder.

For this reason, the model plan eliminates the corporation income tax. The possibility of having corporations withhold taxes on behalf of shareholders, in order to alleviate problems arising when tax liabilities exceeded corporate cash distributions, is examined. It is emphasized that full integration is proposed in the context of a plan that attempts to tax equally income from all sources. "Dividend" integration such as that proposed by the Ford Administration in 1975, which represents, in itself, a desirable change in the absence of comprehensive reform, may also be considered as a transition to the model treatment of corporate income.

Treatment of Capital Gains and Losses

Under the broadest concept of a comprehensive tax base, capital gains that represent an increase in real wealth would be taxed even though not realized by sale or exchange of the asset. Similarly, capital losses, whether realized or not, would be subtracted in full from all sources of income in computing the tax base. The proposal moves in that direction by adopting the integration concept. Full integration provides a practical method for taxing increases in asset values arising from corporate retained earnings, a major source of capital gains in the current system. Capital gains realized upon sale or exchange of assets are taxed fully under the model plan after allowing a step-up in basis for inflation. Because maximum tax rates would be considerably lower if a comprehensive tax base were adopted, there is far less reason for special treatment of capital gains to achieve rough averaging effects in a progressive rate structure. Realized capital losses are fully deductible against ordinary income in the model system.

Thus, the proposal, while ending the current provision for exclusion of one-half of capital gains from the base, will also end the taxation of purely inflationary gains and eliminate current limits on deductibility of realized capital losses. Compared with present law, taxation of capital gains would be lower during periods of rapid inflation and possibly somewhat higher during periods of relative price stability. The proposal does not recommend taxation of gains as accrued (that is, prior to realization) because the administrative cost of annual asset valuations is prohibitive and because otherwise taxpayers might face problems in making cash tax payments when no cash had been realized. The corporate integration proposal would enable the largest part of individual income previously reflected in realized capital gains to be taxed as accrued by eliminating the corporate tax and taxing corporate income directly to the shareholders, whether or not it was distributed. This is a fair and workable solution.

Depreciation Rules

The proposal defines some general principles for measuring depreciation of assets for tax purposes. It is recommended that a systematic approach to tax depreciation, perhaps one modeled after the present Asset Depreciation Range System, be made mandatory for machinery and equipment and structures. A set of accounting procedures would be prescribed that would provide certainty to the taxpayer that his depreciation allowances would be accepted by the tax collector and would reasonably approximate actual declines in the value of these depreciable assets. Cost depletion is recommended in place of percentage depletion for mineral deposits, as a better measure of the income arising from these properties.

State and Local Bond Interest

The proposal suggests that interest from state and local bonds be treated like all other interest receipts in the computation of the tax base, on the grounds that those receipts can be used for consumption or increases in net worth. Transition problems relating to existing bond holdings are recognized. The implicit tax burden in ownership of state and local bonds resulting from their lower interest yield is identified and evaluated. The report mentions alternative, less-costly ways of providing the same subsidy to state and local governments as is presently provided by the interest exemption.

Imputed Income from Consumer Durables

Under the broadest form of comprehensive income base, the imputed return in the form of the rental value of consumption services from ownership of consumer durables would be taxed. The exclusion of this form of income from tax provides an important benefit to home owners. They have invested part of their net worth in their home, rather than investment assets, but the value of the use of their home (the income it produces) is not taxed. This is particularly true when, as under our present system, interest on home mortgages is deductible from other income. This proposal does not recommend taxation of the imputed value of the use of homes and consumer durables because of difficulties of measurement. However, it is recommended that the deductibility of local taxes on noncommercial property, including owner-occupied homes, be reconsidered, on the grounds that this amounts to exclusion of more than the income that would be imputed to such assets.

Itemized Deductions

The report considers options for the treatment of major deductions, including deductions for medical expenses (which could be replaced with a catastrophic insurance program), charitable contributions (which could be eliminated or retained in the same form, without compromising the basic integrity of either the comprehensive income or cash flow tax), state and local income taxes (which would remain deductible) and sales taxes (not deductible) and casualty losses (not deductible). Decisions as to whether, and in what form, major personal deductions should be maintained depend on whether or not these expenditures should be viewed as consumption and on whether or not particular types of activities ought to continue to be encouraged through the tax system. The report presents specific proposals for treatment of major deductions but it is noted that other rules are also consistent with the concept of a comprehensive income base. The deduction of interest is maintained, as is, in modified form, the deduction of child care expenses. The report recommends elimination of the standard deduction, which will be replaced in part by more generous personal exemptions.

Retirement Income and Unemployment Compensation

Under a comprehensive income tax, both contributions to retirement pensions and the interest earned on such contributions would be included in the base. However, a roughly equivalent result is achieved by taxing earnings on pension funds as they accrue and retirement benefits as received and allowing employer and employee contributions to pensions to be deducted from the tax base. This procedure is preferable because it minimizes problems of income averaging. Rules for making different types of pension accounts conform to this principle are outlined in the report. It is proposed that deduction of both employee and employer contributions to Social Security be allowed and that all social security retirement benefits be included in the tax base. The report also recommends that unemployment compensation payments be included in the tax base.

Liberal personal exemptions recommended will insure that persons with very low incomes are not taxed on social security benefits or unemployment compensation.

Choice of a Filing Unit and Exemptions for Family Size

The decision on the appropriate filing unit represents a compromise between objectives that are mutually exclusive under a progressive tax: a system in which families of equal size and income pay equal taxes and a system in which the total tax liability of two individuals is not altered when they marry. The report recommends continuation of family filing, with separate structures of exemptions and rates for married couples, single individuals, and unmarried heads of household. To reduce the work disincentive caused by taxation of secondary earners at marginal rates determined by the income of a spouse, the plan proposes that only 75 percent of the first $10,000 of earnings of secondary workers be included in the tax base. Alternative treatments of the filing unit consistent with the general principles of a comprehensive income base are presented.

The report discusses the issues in the choice between exemptions and tax credits as adjustments for family size, and recommends a per-member exemption instead of a credit. However, it is noted that various methods of adjusting for family size, including use of credits, are fully consistent with the comprehensive income base.

The report shows how adoption of the recommended changes in the tax base would change tax rates. With an exemption of $1,000 per taxpayer and an additional $1,600 per tax return, it is possible under the comprehensive income tax to raise the same revenue with roughly the same distribution of the tax burden by income class as under the present income tax, using only three rate brackets, ranging from 8 percent in the lowest bracket, to 25 percent for middle income taxpayers, to 38 percent for upper income taxpayers. The generous $1,000 personal exemption (instead of $750 under present law) plus an additional $1,600 exemption per return helps provide the same ability-to-pay distribution of the tax burden as present law. Alternatively, it is possible to raise the same revenue under the comprehensive income tax with a flat rate of slightly over 14 percent on all income if there are no exemptions and with a flat rate of slightly under 20 percent with exemptions of $1,500 per taxpayer.

In summary, the comprehensive income tax proposal is a complete plan for a major rebuilding of the tax system that eliminates many of the inconsistencies in the present tax code. The plan clearly demonstrates the feasibility of major improvements in the simplicity, efficiency, and fairness in the income tax.

CASH FLOW, CONSUMPTION BASE TAX

Consumption is less widely advocated than income in discussions of tax reform but it deserves serious consideration as an alternative ideal for the tax base. A consumption tax differs from an income tax in excluding savings from the tax base. In practical terms, this means that net saving, as well as gifts made, are subtracted from gross receipts to compute the tax base. Withdrawals from savings, and gifts and bequests received but not added to net savings, are included in gross receipts to compute the tax base.

Advantages of a Consumption Base

The report shows that a version of a consumption base tax, called the "cash flow tax," has a number of advantages over a comprehensive income tax on simplicity grounds. The cash flow tax avoids the most difficult problems of measurement under a comprehensive income tax -- such as depreciation rules, inflation adjustments, and allocation of undistributed corporate income -- because all forms of saving would be excluded from the tax base.

In addition, the report demonstrates that the cash flow tax is more equitable because it treats alike all individuals who begin their working years with equal wealth and the same present value of future labor earnings. They are treated differently under an income tax, depending on the time pattern of their earnings and the way they choose to allocate consumption expenditures among time periods.

By eliminating disincentives to saving, the cash flow tax would encourage capital formation, leading to higher growth rates and more capital per worker and higher before-tax wages.

How a Consumption Base Could be Taxed

According to one method of designing a consumption tax the taxpayer would include in his tax base all monetary receipts in a given time period, including withdrawals from past savings and gifts and bequests received, and exclude from his tax base current savings, gifts made, and certain itemized expenditures also allowed as deductions under the comprehensive income tax. Thus, the full proceeds of asset sales would be taxed if used for consumption rather than for purchase of other assets (including such "purchases" as deposits in savings accounts). Inclusion of asset sales and deduction of asset purchases from the tax base, make it possible for the tax base to measure an individual's annual consumption without actually tallying up his purchases of consumption goods and services.

A second method of computing the base for a tax based on consumption is to exempt all capital income from tax. Dividends, interest, capital gains, and profit from a personal business would be excluded from an individual's tax base. Interest receipts would be excluded from the base, and interest payments on loans would not be deducted. Purchases of productive assets would not be deductible, because the returns from them would not be included in the base.

These alternative treatments of assets lead to a tax base with the same present value. Deferral of tax in the present leads to payment of the same tax plus interest when the asset is sold for consumption. However, the payment of taxes occurs later under the method which allows a savings deduction than under the method which allows an interest exemption.

Similarities to the Present Tax Base

The report points out that the current tax system is closer to a cash flow tax than to a comprehensive income tax in its treatment of many forms of income from capital. In particular, two important sources of saving for many Amercans -- homeownership and employer contributions to retirement annuities (or contributions of individuals to Keogh Plans and IRA's) -- are treated under the current law almost exactly the same way they would be treated under a consumption tax which allows a deduction for savings. Similarly, many of the present system's uncoordinated exclusions of capital income from tax approximate the second approach to a consumption base tax. Thus, the model cash flow tax is not as complete a change from the present tax system as it might seem.

Treatment of Investments in the Model Plan

In the model cash flow tax individuals may choose between the two essentially equivalent ways of treating investments. Purchases of assets are eligible for deduction only if made through "qualified accounts." The qualified accounts would keep records of an individual's net investment balance so that annual saving and dissaving can be measured. Each year, net contributions to qualified accounts would be computed and subtracted from the tax base. If withdrawals exceed contributions in any year, the difference would be added to the tax base. Thus, the proceeds from an investment made through a qualified account are subject to tax only when withdrawn.

Savings not deposited in a qualified account are not eligible for deduction, but the interest and capital gains from investments financed by such saving are not included in the tax base. There is no need to monitor the flow of investments or the investment income earned outside of qualified accounts because they have no place in the calculation of tax.

The report spells out the consequences of allowing a taxpayer to choose between alternative ways of being taxed on income from assets, providing specific examples of how the tax would work. It is shown how allowing two alternative treatments for both assets and loans provides a simple averaging device that would enable taxpayers to avoid the inequities associated with applying a progressive rate system to individuals with different annual variation in the level of consumption. The report also shows how allowing alternative treatment of assets and loans simplifies the measurement of the tax base.

Other Features of the Cash Flow Tax

Under the proposal, all consumer durables (such as automobiles and homes) are treated as assets purchased outside of a qualified account. No deductions are allowed for the purchase of a consumer durable, and receipts from the sale of a consumer durable are not included in the tax base.

Gifts are treated differently under the cash flow tax than under both the comprehensive income tax and the current tax system. In the cash flow tax proposal, gifts and inheritances received are included in the tax base, while gifts given are deducted. Under present income tax law and under the model comprehensive income tax the treatment is reversed, with gifts received excluded from the donee's tax base but no deduction allowed for an individual who makes a gift. It is assumed that in both systems there would continue to be a separate tax on transfers of assets by gift or bequest, such as the present estate and gift tax.

The proposal describes in detail how specific items of capital income -- dividends, interest, capital gains, income from personal business, and accumulation of retirement pensions -- are treated. The corporate income tax is eliminated because there is no longer a need to tax undistributed corporate income. Purchases of corporate stocks through qualified accounts are tax deductible, while all withdrawals from qualified accounts are included in the tax base. Sale proceeds of corporate stock, dividends, and interest, if remaining in the qualified account, are not taxed.

The cash flow tax, like the comprehensive income tax, would move towards neutrality in the tax treatment of different kinds of investments. In doing so, both proposals would have the effect of encouraging the best use of available capital. In addition the cash flow tax would eliminate the discouragement to capital formation inherent in the concept of a tax on income.

The Filing Unit and Tax Rates

The cash flow tax proposal treats definition of the filing unit, exemptions for family size, and deductions of personal consumption items the same way as the comprehensive income tax proposal. The differences between the two proposals are in the treatment of items which represent a change in net worth, or income from capital, and in the treatment of gifts and inheritances.

Under the cash flow tax, an exemption of $800 per person and $1,500 per return together with the three rate brackets -- 10 percent, 28 percent, and 40 percent -- would allow present tax revenues to be raised while maintaining the same vertical distribution of tax burdens.

TRANSITION PROBLEMS

Reforming the existing tax system poses a different set of problems than designing a new tax system from scratch. Although the report concentrates on the design of approximations to ideal tax systems, the problems of transition have also been examined and possible solutions embodied in specific proposals.

Transition to a new set of tax rules poses two separate, but related problems. First, changes in rules for taxing income from capital will lead to changes in the relative value of assets. Problems of fairness would exist if investors who had purchased a particular type of asset in light of the present tax system were subjected to losses by sudden major changes in tax policy. Similarly, changes in tax policy may provide some investors with windfall gains. Second, changes in the tax law raise questions of what to do about income earned before the effective date, but not yet subject to tax. For example, the comprehensive income tax, which proposes full inclusion of capital gains in the base (subject to an inflation adjustment), requires a transition rule for taxing capital gains accumulated before, but realized after, the effective date.

The report describes two methods for moderating the wealth effects of tax reform--"grandfathering," or exempting existing assets from the new tax provisions, and phasing-in of the new rules. Specific proposals for use of these instruments for projected changes in the tax code are presented. The report also outlines specific transition proposals for handling income earned before the effective date, but not yet taxed.

HOW AN INDIVIDUAL WOULD CALCULATE TAX LIABILITY UNDER THE REFORM PLANS

Elements Common to Both Plans

The method of calculating tax liabilities under the model tax systems would be similar to the method in use today. Taxpayers would fill out a form like the Form 1040, indicating family status and number of exemptions. There would not be a standard deduction under either plan. Taxpayers who had eligible deductions would choose to itemize; to reduce the number of itemizers, deductions would be subject to floor amounts.

The tax base would be calculated on the form, and the tax rate schedule appropriate to the filing unit (i.e., single, married, head of household) would be applied to compute tax liability. Taxes owed and refunds due, would depend on the difference between tax liability and taxes withheld as reported on W-2 statements or estimated tax paid.

The wages and salaries of the primary wage earner would remain the biggest item in the tax base of most households and would be entered into the calculation of income the same way as under the current system. The first $10,000 of wages and salaries of secondary wage earners would be multiplied by .75 before being added to the tax base. The rules for calculating some deductions (e.g., child care) would be changed, and other deductions (e.g., property and gasoline taxes) would be eliminated.

The Comprehensive Income Tax

Under the comprehensive income tax, some additional items would be added to the computation of tax. Corporations would supply to all stockholders a statement of the amount of profit attributed to that stockholder in the previous year, and an adjustment to basis that would rise with earnings and fall with distributions. Similar statements of attributed earnings would be supplied to taxpayers by pension funds and insurance companies. In addition to the income reported in these statements, taxpayers would report income from interest on State and local bonds, unemployment compensation, and social security retirement benefits.

All capital gains (or losses) would be entered in full in the computation of taxable income. The basis for corporate shares would be increased by corporate income taxed but not distributed to them. In computing gains from sale or exchange, the taxpayer would be allowed to adjust the basis of assets sold for inflation. A table of allowable percentage basis adjustments would be provided in the tax form. The taxpayer would use statements received from corporations to adjust the basis of corporate shares upward for any past attributed corporate profits and downward for dividends or other distributions received.

The Cash Flow Tax

The major change under the cash flow tax is that the taxpayer would receive yearly statements of net withdrawals or deposits from all qualified accounts. If deposits exceeded withdrawals, the difference between deposits and withdrawals would be subtracted from the tax base. If withdrawals exceeded deposits, the difference would be added to the tax base.

Interest, dividends, and capital gains realized on investments made outside of qualified accounts would not be reported on the tax form and would not be included in taxable income. The rationale for this is that the tax would have been pre-paid, because no deduction was allowed at the time of purchase.

Gifts and inheritances received would be included in the tax base (but if deposited in a qualified account would have an offsetting deduction). A deduction would be allowed for gifts and bequests given. The identity of the recipient of deductible gifts would be reported on the donor's return.

CHAPTER-BY-CHAPTER OUTLINE OF THE REMAINDER OF THE REPORT

Chapter 2 -- What is to be the Tax Base?

Chapter 2 reviews the main issues in choosing an appropriate tax base (the sum to which the structure of exemptions and rates is applied) and presents the case for considering a cash flow tax based on consumption as an alternative to a reformed comprehensive income tax. General issues of equity in design of a tax system are discussed, and the concepts of consumption and income are explained in detail. It is shown that the current tax system contains elements of both a consumption base and a comprehensive income base. Thus, it is shown how the adoption of a consumption or cash flow tax would not be as great a change from the present system as it might seem. The alternative tax bases are compared on grounds of equity, simplicity, and effects on economic efficiency.

Chapter 3 -- A Model Comprehensive Income Tax

A model comprehensive income tax is presented in chapter 3. The major innovations in the plan relate to integration of the corporation and individual income taxes, and to tax treatment of capital gains, State and local bond interest, income accumulated in pensions and life insurance funds, retirement income, and unemployment compensation. Changes in many personal deductions are suggested. Important recommendations for changes in the filing unit, adjustment for family size, and taxation of secondary wage earners are set forth. International considerations in income taxation are discussed briefly. The chapter concludes with a description of a sample form for tax calculation under the comprehensive income proposal.

Chapter 4 -- A Model Cash Flow Tax

In chapter 4, a model cash flow tax based on consumption is presented. The major innovation in the cash flow tax is that savings may be deducted from the tax base. The use of qualified accounts to measure the flow of saving and consumption is proposed. The equivalence between deductibility of saving and exclusion of capital earnings from tax is explained, and alternative treatments of assets reflecting this equivalence are presented. Treatment of specific items under the model cash flow tax is proposed in detail and compared with treatment of corresponding items under the comprehensive income tax. Arguments against the cash flow tax on grounds of progressivity and effects on wealth distribution are evaluated. The use of a supplementary wealth transfer tax to provide greater progressivity is explored. The chapter concludes with a description of a sample tax form under the cash flow proposal.

Chapter 5 -- Quantitative Analyses

Chapter 5 presents simulations of the effects of the proposed reforms on the tax liabilities of different groups of taxpayers. The chapter demonstrates that the vertical structure of tax burdens under the present income tax system may be broadly duplicated with a more generous set of exemptions and a rate schedule which is more moderate and much simpler so long as the tax base is greatly broadened as proposed under either the comprehensive income tax (chapter 3) or the cash flow consumption type tax (chapter 4).

Chapter 6 -- Transition Considerations

Chapter 6 proposes transition rules to accompany adoption of the model tax plans. Problems which may arise in changing tax laws are explained, and instruments to ameliorate adjustment problems, including exempting existing assets from changes and phasing in new rules, are described and evaluated. Specific proposals are presented for transition to both a comprehensive income base and a cash flow base that cover the timing of the application of new rules to specific proposed changes in the tax code.

Table 1

Summary Comparison of Model Tax Plans

Item	Current tax	Model comprehensive income tax	Model cash flow tax
Corporate income			
a. Retained earnings	Separately taxed to corporations	Attributed to individuals as income and included in tax base	No tax until consumed
b. Dividends	Separately taxed to corporations, included in individual tax base with $100 exemption	Not taxed separately	No tax until consumed
Capital gains	50% of long-term gains included when realized; alternative tax available	Fully included in tax base on realization; no partial exclusion	No tax until consumed
Capital losses	50% of long-term losses deductible against included portion of long-term gains and $1,000 of ordinary income; carryover of losses allowed	Fully deductible from tax base on realization	No tax offset unless consumption is reduced
Depreciation	Complex set of depreciation rules for different types of equipment and structures	Reformed rules for depreciation; depreciation to approximate actual decline in economic value on a systematic basis by industry classes	Permits expensing of all business outlays, capital or current

Table 1

Summary Comparison of Model Tax Plans
(continued)

Item	Current tax	Model comprehensive income tax	Model cash flow tax
State and local bond interest	Excluded from tax base	Included in tax base	Excluded from tax base until consumed
Other interest received	Included in tax base	Included in tax base	Excluded from tax base until consumed
Proceeds of loans	Excluded from tax base	Excluded from tax base	Inclusion in tax base optional
Interest paid on loans	Deducted from tax base	Deducted from tax base	Deducted from tax base if proceeds of loan included in base
Principal repayments on loans	Not deducted from tax base	Not deducted from tax base	Deducted from tax base if proceeds of loan included in base
Rental value of owner-occupied homes	Excluded from tax base	Excluded from tax base	Implicitly included in tax base because purchase treated as consumption
State or local property, sales and gasoline taxes (non-business)	Deducted from tax base	Not deducted from tax base	Not deducted from tax base
Medical expenses 1/	Expenses over 3% of adjusted gross income deducted from tax base	No deduction; possible credit for expenses over 10% of income*	No deduction; possible credit for expenses over 10% of consumption*
Charitable contributions 2/	Deducted from tax	Not deducted from base*	Not deducted from tax base*

Table 1

Summary Comparison of Model Tax Plans
(continued)

Item	Current tax	Model comprehensive income tax	Model cash flow tax
Casualty losses	Uninsured losses deducted from tax base*	Not deducted from tax base*	Not deducted from tax base
State and local income taxes	Deducted from tax base	Deducted from tax base*	Deducted from tax base*
Child care expenses 3/	Limited tax deduction	Revised tax deduction*	Revised tax deduction*
Contributions to retirement pensions	Employer contributions untaxed; employee contributions taxed	All contributions excluded from tax	All contributions excluded from tax
Interest earnings on pension funds	Excluded from tax	Attributed to employer or to individuals and taxed in full as accrued	Excluded from tax
Retirement benefits from pension funds	Included in tax base except for return of employee contribution	Included in tax base	Included in tax base unless saved
Social security contributions	Employer contributions untaxed; employee contributions taxed	All contributions excluded from tax	All contributions excluded from tax
Social security retirement income and unemployment compensation	Excluded from tax base	Included in tax base	Included in tax base unless saved
Wage and salary income 4/	Included in tax base	Included in tax base for primary earner; for secondary earners, 75% of wages under $10,000 and all wages over $10,000 included*	Included in tax base for primary earner; for secondary earners, 75% of wages under $10,000 and all wages over $10,000 included*; savings out of wages deductible

Table 1

Summary Comparison of Model Tax Plans
(continued)

Item	Current tax	Model comprehensive income tax	Model cash flow tax
Deposits in qualified investment accounts	No tax consequences	No tax consequences	Deducted from tax base
Withdrawals from qualified investment accounts	No tax consequences	No tax consequences	Included in tax base
Standard deduction	Available to non-itemizers only; $1,600 or 16% of adjusted gross income up to $2,400 for single taxpayer, $1,900 or 16% of adjusted gross income up to $2,800 for married couple filing jointly	No standard deduction; $1,600 per return exemption	No standard deduction; $1,500 per return exemption
Personal exemptions	$750 per individual; extra exemptions for aged and blind	$1,000 per individual	$800 per individual

Office of the Secretary of the Treasury
Office of Tax Analysis

* Indicates alternative treatments possible.

1/ Medical deduction optional under model tax plans. Alternative ways of structuring deduction or credit possible.

2/ Charitable deduction optional under model tax plans. Other alternatives possible, including limited credit.

3/ Child care deduction and its form and limits optional under model tax plans.

4/ Treatment of secondary earners optional under model tax plans.

Chapter 2

WHAT IS TO BE THE TAX BASE?

INTRODUCTION

The dominant complaint made about the present tax system is that it does not tax all income alike. This complaint reflects concern about equity: taxpayers with the same level of income bear different tax burdens. It reflects concern about efficiency: taxation at rates that differ by industry or by type of financial arrangement leads to misallocation of resources. Finally, it reflects concern about simplicity: the enormously complex tangle of provisions the taxpayer confronts in ordering his affairs and calculating his tax leads to differential rates of taxation.

The usual approach to the complaint that all income is not taxed alike is to attempt to make income as defined by tax law correspond more closely to the "real thing." The problem with this approach is the difficulty of identifying the "real thing." As with other abstractions, there are numerous ways to look at the concept of "income," some of which may be better or worse according to context.

Laymen find it hard to believe that there are major problems in defining income. They are used to thinking in terms of cash wages and salaries, which are easily identified and clearly income. In fact, wages and salaries account for the great bulk of income -- however defined -- in the U.S. economy; other items like interest and dividends are also easily identified. So it may be fairly said that most of the dollars identified as income in the total economy will be the same under any definition of income.

But as one approaches the edges of the concept of income, there is a substantial grey area. It is small compared with the bulk of income, but this grey area (capital gains, for example) is the focus of much controversy. There is an extensive literature on the subject, beginning before the turn of the century and continuing to the present, with no consensus except that particular definitions may be more practical in certain circumstances than in others.

Many of the major problems in defining income concern expectations or rights with respect to the receipt of payments in the future -- does an individual have income when the expectation or right arises, or only when the money comes in? Is the promise to pay a pension to be counted as income when made, although the amounts will be paid 20 years hence? Is a contract to earn $60,000 a year for the next 5 years to be discounted and counted as income in the year the contract is made? Is the appreciation in the market value of an outstanding bond resulting from a decline in the general market rate of interest to be counted as income now, even though that appreciation will disappear if interest rates rise in the future? Is the increase in the present value of a share in a business attributable to favorable prospects of the business earning more in future years to be counted as income now or in the future years when the earnings actually materialize?

Differences in view with respect to the definition of income cut across political philosophies. Although many "liberal" economists argue for an expansive definition of income, the extreme view that income cannot be defined adequately to constitute a satisfactory tax base has been advanced by the eminent British Socialist economist, Nicholas Kaldor, who argues for a consumption tax. At another extreme, one of the most all-inclusive definitions of income was formulated by Professor Henry Simons, a conservative economist long affiliated with the University of Chicago.

Professor Simons' definition -- usually referred to as the "Haig-Simons definition" or the "accretion" concept of income -- is perhaps most commonly used in discussions about income taxes. Professor Simons himself was careful to say that the definition was not suitable for all purposes and would not, without modification, describe a satisfactory tax base. Most analysts would agree. However, the definition is useful for analytical purposes. It represents a kind of "outer limit" that helps identify items that are potential candidates for inclusion or exclusion in any income tax base. In the discussions that follow, it should be understood that the Haig-Simons or "accretion" definition is used and discussed in that way, and that no blanket endorsement of that definition of income is intended.

Indeed, the accretion concept of income has many shortcomings as a tax base. Several of them are serious, and attempts to deal with them account for much complexity in the present tax code. Among these shortcomings are severe measurement problems. Many items that are required for the calculation of net income must be imputed -- either guessed at or determined by applying relatively arbitrary rules (as in the case of depreciation). Because such rules are never perfect, they are the subject of continual controversy. A particular problem with certain current rules is their inability to measure income correctly in periods of inflation.

An especially serious drawback of an accretion income base is that it leads to what is sometimes called the "double taxation" of savings: savings are accumulated after payment of taxes and the yield earned on those savings is then taxed again. This has been recognized as a problem in the existing tax law, and many techniques have been introduced to make the tax system more neutral with respect to savings. The investment tax credit, accelerated depreciation, special tax rates for capital gains, and other provisions are examples. Also, tax deferral on income from certain investments for retirement purposes is an example of how current law attempts to offset the adverse effects on savings of using an accretion income base. Significantly, this last example is also viewed as desirable for reasons of equity.

All these techniques have the same practical effect as exempting from tax the income from the investment. <u>To this extent, this is equivalent to converting the base from accretion income to consumption</u>.

The present tax system thus may be regarded as having a mixture of consumption and accretion income bases. In view of this, a question that arises is whether the proper objective of tax reform should be to move <u>more</u> explicitly toward a consumption base rather than toward a purer accretion base. The issue is considered in this chapter.

The analysis suggests that the consumption tax has many important advantages as compared with an income tax and accordingly should be seriously considered in designing a reformed tax system. In some respects, a broad-based consumption tax is more equitable than a broad-based income tax. It is also easier to design and implement and has fewer harmful disincentive effects on private economic activity. In many important ways, a broad-based consumption tax more closely approximates the current tax system than does a broad-based income tax and would constitute <u>less</u> of a change.

The remainder of this chapter compares consumption and income taxes with respect to various criteria. The chapter includes:

- A discussion of some general issues relating to equity;
- An explanation of the concepts of consumption and income, including a discussion of some definitional problems;
- A comparison of the treatment of personal savings under the current tax system with the treatment of savings under a consumption tax and a broad-based income tax;
- A discussion of the merits of the alternative tax bases on criteria of equity;
- A comparison of the alternative tax bases for simplicity; and
- A discussion of the economic efficiency effects of tax policies and a comparison of the efficiency losses under a consumption tax and an income tax.

TWO PRELIMINARY MATTERS OF EQUITY

As has already been suggested, the specification of a tax code has the effect of defining the conditions under which two taxpayers are regarded as having the same circumstances, so that they should properly bear the same tax burden. This section considers two aspects of such a comparison that have important implications for tax design: first, over what period of time are the circumstances of two taxpayers to be compared; and, second, what are the units -- individuals or families -- between which comparisons are to be drawn.

Equity Over What Time Period?

Most tax systems make liabilities to remit payments depend upon events during a relatively short accounting period. In many cases, this is a matter of practical necessity rather than principle. That is, tax liabilities must be calculated periodically on the basis of current information. Generally, there is nothing sacred about the accounting period -- be it a week, a month, or a year -- as far as defining the period over which taxpayer circumstances are to be compared. Indeed, it is usually regarded as regrettable that practical procedures do not allow the calculation of liabilities to take a much longer view. Averaging and carryover provisions represent (inadequate) attempts to resolve inequities that arise in this respect.

An example from another program will illustrate. Under many welfare programs the accounting period is 1 month. A family earning just at the eligibility level at an even rate for the year will receive nothing. A family earning the same amount during the year, but earning it all during the first 3 months will appear to have _no_ earnings during the remaining 9 months. That family _will_ then be eligible for _full_ benefits for 9 months, in spite of being no worse off _than_ the first family in the perspective of a year's experience.

It is assumed in this study that the period over which such comparisons are made should be as long as possible. Ideally, two taxpayers should be compared on the basis of a whole _lifetime_ of circumstances, and this is taken here to be a _general_ goal of tax system design: lifetime tax burden should depend upon lifetime circumstances.

It is important to note that lifetime tax burden depends not only on the sum of all tax liabilities over a taxpaying unit's lifetime, but also on their timing. Deferral of a portion of tax liability is a form of reduction in tax burden in an income tax framework because interest can be earned on the deferred tax payments. For example, if investors can expect a 10-percent annual rate of return on riskless assets, a tax liability of $110 a year from now is equivalent to a tax liability of $100 today because $100, if untaxed and invested, will grow to $110 in value in one year's time. A common way of expressing this is to say that the _present value_ of a tax liability of $110 one year in the future is _$100_. When comparing the lifetime tax burdens of two taxpayers, we are, in fact, comparing the present value of the sum of current and future tax liabilities viewed from the vantage of some point early in the life of the two taxpayers (e.g., at birth, or at the beginning of working years, or at age 18).

Is the Family or the Individual the Appropriate Unit?

What taxpaying unit is the subject of this comparison of situations? When it is asked whether one taxpayer is in the same situation as another, is the taxpayer an individual or a family? The sharing of both consumption and wealth within families supports continuation of present law in regarding the family as the unit of comparison.

On the other hand, a family is not a simple institution, with a predictable lifetime, and a constant identity. Quite apart from the problem of distinguishing varying degrees of formality in family structure (e.g., is the second cousin living in the guest room part of the family?), the family necessarily is a changing unit, with births, deaths, marriages, and divorces continually altering family composition.

In this study, differences in family association have been regarded as relevant to that comparison of lifetime situation by which relative tax burdens are to be assigned to different individuals. The practical consequence of this will be that the tax liability of a father, for example, will depend in part upon consideration of the situation of the whole family.

INCOME AND CONSUMPTION

A tax base is not a quantity like water in a closed hydraulic system, wherein the total remains constant regardless of how it is directed by valves and pumps. Rather, it is an aggregation of transactions -- sometimes implicit but usually voluntary. The transactions that take place will depend in part upon how they are treated by the tax system. The choice of a tax base is a choice about how to tax certain transactions.

A tax base is necessarily defined by a set of accounting rules that classifies actual and implicit transactions as falling within or outside the "tax base," that is the total to which a tax schedule is applied to determine the taxpayer's liability. The Internal Revenue Code prescribes an "income" tax, with "income" defined by the elaborate body of statutory and administrative tax law that has evolved. But this definition is criticized by many observers, who believe that tax burdens should be related to a broader tax base, i.e., to a wider set of transactions.

As was pointed out above, the concept of income generally used in discussion of tax reform has been called an "accretion" concept. It is supposed to measure the command over resources acquired by the taxpayer during the accounting period, that command having been either exercised in the form of consumption or held as potential for future consumption in the form of an addition to the taxpayer's wealth. Hence, the apparently paradoxical practice of defining "income" by an "outlay" or "uses" concept -- consumption plus change in net worth.

Everyday usage on the other hand tends to associate income with the sources side of the accounts. Thus, one speaks of income "from labor," such as wages, or income "from capital," or "from proprietorships," such as interest and profits. Because sources and uses must be equal in a double entry accounting system, the result should be the same whichever side is taken for purposes of measurement, provided that all uses are regarded as appropriate for inclusion in the tax base.

Definitions of Income and Consumption

In this section, a rudimentary classification of transactions is developed to define income and consumption. The accounts considered first are those of a wage earner whose only sources of funds are his wages and his accumulated balance in a savings account.

In the simplest case, the possible applications he can make of these funds may be divided into the purchase of goods and services for his immediate use and additions to or subtractions from his accumulation of savings. Thus, an account of his situation for the year might be the following:

SOURCES	USES
Wages	Rent
Interest	Clothing
Balance in savings account at beginning of period	Food
	Recreation
	Balance in savings account at end of period

The two sides of this account are, of course, required to balance. Of the uses, the first four are generally lumped under the concept of consumption, the last constituting the net worth of the household. Thus, the accounts may be schematically written as:

SOURCES	USES
Wages Interest Net worth at beginning of period	Consumption Net worth at end of period

The concept of income concerns the additions or accretions to source and the application of that accretion during the accounting period. This can be found simply by subtracting the accumulated savings (net worth) at the beginning of the period from both sides, to give:

ADDITION TO SOURCES	USES OF ADDITION TO SOURCES
Wages Interest	Consumption Savings (equals increase in net worth over the period)

Income is defined here as be the sum of consumption and increase in net worth. Note carefully that a uses definition is adopted as a measure of differences in individual circumstances. This approach to the concept of income has substantial advantages as a device for organizing thinking on particular policy issues, even though it will no doubt be unfamiliar to many readers, who naturally think of income as something that "flows in" rather than as something that is used. With this uses definition of income, the situation of the illustrative individual may be represented by:

ADDITION TO SOURCES	USES OF ADDITION TO SOURCES
Wages Interest	Income

The last version of the accounts makes clear the way in which information about sources is used to determine the individual's income. To calculate his income for the year, this individual obviously would not add up his outlays for rent, clothing, food, recreation, and increase in savings account balance. Rather, he would simply add together his wages and interest and take advantage of the accounting identity between this sum and income.

This classification of uses into consumption and increase in net worth is not sufficient, however, to accommodate distinctions commonly made by tax policy. It will be helpful, therefore, to refine the accounts to the following:

ADDITION TO SOURCES	USE OF ADDITION TO SOURCES
Wages Interest	Consumption Cost of earnings Certain other outlays Increase in net worth

An individual's outlay for special work clothes needed for his profession requires the category "cost of earnings." These are netted out in defining income. Note that the decision about which outlays to include in this category is a <u>social</u> or <u>political</u> one. Thus, in present law, outlays for specialized work clothes are deductible, but commuting expenses are not. There is no independent standard to which one can appeal to determine whether such outlays are consumption, and hence a part of income, or work expenses, and hence out of income.

Similarly, a judgment may be made that some outlays, while not costs of earning a living, are also not properly classified as consumption. The category of "other outlays" is introduced for want of a better label for such transactions. For example, in everyday usage, State income taxes would not be an application of funds appropriately labeled "personal consumption," much less "increase in net worth." (They might be allocated to the "cost of earnings" category.) Thus, using the definition of income as the sum of consumption and the increase in net worth, we now have:

ADDITION TO SOURCES	USES OF ADDITION TO SOURCES
Earnings (Wages + Interest)	Income (Consumption + Increase in net worth) Cost of earnings Certain other outlays

Again, to calculate income it is generally convenient to work from the left-hand, sources side of the accounting relationship described above. In this case,

Income = Earnings
minus
Cost of earnings
minus
Certain other outlays.

Similarly, and of great importance in understanding this study, consumption may be calculated by starting with sources data:

Consumption = Earnings
minus
Cost of earnings
minus
Certain other outlays
minus
Increase in net worth.

One further addition to the accounting scheme is needed at this point: the item "gifts and bequests given." This is a use of funds that some would regard as consumption, but in this report the term consumption, without modifier, is reserved for the narrower notion of goods and services of direct benefit to the individual in question. The accounts now have the following structure:

ADDITION TO SOURCES	USES OF ADDITION TO SOURCES
Wages	Consumption
Interest	Gifts and bequests given
	Cost of earnings
	Certain other outlays
	Increase in net worth

It must be decided whether gifts and bequests given are to be regarded as income, that is, as a component of the total by which taxpayers are to be compared for assigning burdens. The term "ability-to-pay" is used to describe the income concept that considers income to be the sum of consumption plus gifts and bequests given plus increase in net worth, because it is within the taxpayer's ability to choose among these uses and, hence, all three measure taxpaying potential equally. It should be emphasized that the label "ability-to-pay" is intended to be suggestive only. There is no agreed upon measure of the idea of a taxpayer's ability to pay. Because of this, quotation marks will be used when the term "ability-to-pay" is used in its role as a label for an income or consumption concept.

"Ability-to-pay" income or consumption would also generally be calculated by starting on the sources side:

"Ability-to-pay" income = Earnings
minus
Cost of earnings
minus
Certain other outlays.

"Ability-to-pay" consumption = Earnings
minus
Cost of earnings
minus
Certain other outlays
minus
Increase in net worth.

The difference between consumption and income is the savings or increase in net worth over the period. Thus, equivalently:

"Ability-to-pay" consumption = "Ability-to-pay" income
minus
Increase in net worth.

Finally, there is the pair of income and consumption concepts that excludes gifts and bequests given from the category of uses by which tax burdens are to be apportioned. These are given the label "standard-of-living" because they are confined to outlays for the taxpayer's direct benefit. As with the term "ability-to-pay," this label is intended to be suggestive only. The "ability-to-pay" and "standard-of-living" concepts are related as follows:

"Standard-of-living" income = "Ability-to-pay" income
minus
Gifts and bequests given,

"Standard-of-living" consumption = "Standard-of-living" income
minus
Increase in net worth.

This discussion leads to a four-way classification of tax bases:

		Gifts Given: Included	Gifts Given: Excluded
Increase in net worth	Included	Ability-to-pay income	Standard-of-living income
	Excluded	Ability-to-pay consumption	Standard-of-living consumption

THE PRESENT TAX BASE

Is the Present Base Consumption or Income?

While the present income tax system does not reflect any consistent definition of the tax base, it has surprisingly many features of a "standard-of-living" consumption base.

The idea of consumption as a tax base sounds strange and even radical to many people. Nonetheless there are many similarities between a consumption base tax and the current tax system. Adoption of a broad-based consumption tax might actually result in less of a departure from current tax treatment of savings than adoption of a broad-based income tax.

The current tax system exempts many forms of savings from tax. In particular, the two items that account for the bulk of savings for most Americans, pensions and home ownership, are treated by the present tax code in a way that is more similar to the consumption model than to the comprehensive income model.

Retirement savings financed by employer contributions to pension plans (or made via a "Keogh" or "Individual Retirement Account" (IRA)) are currently treated as they would be under a consumption tax. Under the current system, savings in employer-funded pension plans are not included in the tax base, but retirement benefits from those plans, which are available for consumption in retirement years, are included. Employee contributions to pension plans are treated somewhat less liberally. The original contribution is included in the tax base when made, but the portion of retirement income representing interest earnings on the original contributions is not taxed until these earnings are received as retirement payments. If the tax on those interest earnings were paid as the earnings accrued, treatment of employee contributions to pension plans would be the same as that under a comprehensive income tax. However, the tax on interest earnings in pension funds is lower than under a comprehensive income base because the tax is deferred. If no tax were paid on the interest earnings portion of retirement pay, then the present value of tax liability would be exactly the same as the present value of tax liability under a consumption tax. Thus, the current treatment of employee contributions incorporates elements of both the comprehensive income model and the consumption model but, because of the quantitative importance of tax deferral on pension fund earnings, the treatment is closer to the consumption model.

The current tax treatment of home ownership is very similar to the tax treatment of home ownership under a consumption tax. Under present law, a home is purchased out of tax-paid income (is not deductible), and the value of the use of the home is not taxed as current income. Under a consumption tax, two alternative treatments are possible. Either the initial purchase price of the house would be included in the tax base (i.e., not deductible in calculating the tax base) and the flow of returns in the form of housing services would be ignored for tax purposes, or the initial purchase price would be deductible and an imputation would be made for the value of the flow of returns, which would be included in the tax base.

In equilibrium, the market value of any asset is equal to the net present value of the flow of future returns, either in the form of monetary profits or value of consumption services. For example, the market value of a house should equal the present value of all future rental services (the gross rent that would have to be paid to a landlord for equivalent housing) minus the present value of future operating costs (including depreciation, operating costs, property taxes, repairs, etc.). Thus, in both cases, the present value of the tax base would be the same. For example, if an individual purchased a $40,000 house, the present value of his future tax base for that item of consumption would be $40,000 regardless of how he chose to be taxed. Because the initial purchase price is easier to observe than the imputed service flow, it would be most practical, under a consumption tax, to include the purchase of a house in the tax base and exclude net imputed returns. In that case, capital gains from sale of a house would not be taxable.

In the current tax system, as in the consumption tax system, the down payment and principal payments for an owner-occupied residence are included in the tax base, and the imputed net rental income in the form of housing services is excluded from tax. Capital gains from housing sales are taxable at preferential capital gains rates upon realization (which allows considerable tax deferral if the house is held for a long period), and no capital gains tax is levied if the seller is over 65 or if the gain is used to purchase another house.

In contrast, under a comprehensive income base, the entire return on the investment in housing, received in the form of net value of housing services, would be subject to tax and, in addition, the purchase price would not be deductible from the tax base.

Many special provisions of the tax law approximate a consumption tax in the lifetime tax treatment of savings. For example, allowing immediate deduction for tax purposes of the purchase price of an item that will be used up over a period of years (i.e., immediate expensing of capital investments) is equivalent to consumption tax treatment of investment income because it allows the full deduction of savings; thus, accelerated depreciation approximates the consumption tax approach. While depreciation provisions under the present law are haphazard, a consumption base tax would allow the immediate deduction of saving to <u>all</u> savers.

In conclusion, taxation of a significant portion of savings under the current system more closely resembles the consumption model than the comprehensive income model. For owner-occupied housing, a large fraction of pension plans, and some other investments, the tax base closely approximates either the present value of imputed consumption benefits or the present value of consumption financed by proceeds of the investment.

Is the Tax System Presently on an "Ability-to-Pay" or a "Standard-of-Living" Basis?

Three possibilities may be considered for the income tax treatment of a gift from one taxpaying unit to another: (1) the gift might be deducted from uses in calculating the tax base of the donor and included in sources in calculating the base of the donee; (2) it might be left in the base of the donor and also included in the base of the donee; or (3) it might be left in the base of the donor but excluded from the base of the donee.

The first of these treatments is that implied by a "standard-of-living" basis for determining relative tax burdens. The second treatment expresses an "ability-to-pay" view. The third treatment is that of the present income tax (excluding the estate and gift tax) law, at least with respect to property, with no unrealized appreciation at the time the gift is made.

The first and third treatments are similar in that there is no separate tax on the transfer of wealth from one taxpaying unit to another. The tax burdens under those two options may differ with a progressive tax structure, however. Under the third treatment, aggregate tax liability is unaffected by the gift, but under the first, it will rise or fall depending on whether or not the marginal tax bracket of the donee is higher than the marginal tax bracket of the donor. Under the second treatment, with the gift or bequest in the tax base of both the donor and the donee, the consumption or change in net worth financed by the gift is, in effect, taxed twice. It is taxed as consumption by the donor, and then taxed again as consumption or an increase in net worth of the donee.

To illustrate the alternative treatments of wealth transfers, consider the case of taxpayers A and B, who start life with no wealth and who are alike except that A decides to accumulate an estate. Their sons, A' and B', respectively, consume their available resources and die with zero wealth. Thus, A has lower consumption than B; A' (who consumed what his father saved) has higher consumption than B'. Under a "standard-of-living" approach, the pair A-A' should bear roughly the same tax burden as the pair B-B'. This is so because the higher consumption of A' is simply that which his father, A, did not consume. Under an "ability-to-pay" approach, the combination A-A' should bear more tax than B-B'. A and B have the same ability to pay, but because A chooses to exercise his ability to pay by making a gift to his son, A' has a greater ability to pay than B', by virtue of the gift received.

Neglecting the effect of progressivity, present income tax law taxes the combination A-A' the same as it does the combination B-B' (whether or not A and A' are related). In this respect, present income tax law incorporates a "standard-of-living" basis. The way this is accomplished, however, is "backward." That is, instead of taxing A on his "standard-of-living" income and then taxing A' on his "standard-of-living" income, present law taxes A on his consumption plus increase in net worth plus the gift given (i.e., the gift is not deductible in calculating the income tax due from A), while A' is taxed on the value of his consumption plus increase in net worth minus the value of the gift received (i.e., the receipt of the gift is not included in calculating the tax due from A').

This procedure clearly mismeasures the income of A. It mismeasures the income of A', as well, if a "standard-of-living" concept of income is used. The income of A' is understated (gift received is not included) and that of A is overstated (gift given is not excluded). However (continuing to neglect the effect of progressivity), the impact of the tax system on A and A' is the same as if the treatment were the other way around, at least as far as intentional gifts are concerned. Suppose, for example, that A wants to enable A' to have an extra $750 worth of consumption. Under present law, A simply gives A' $750 cash and A' consumes it. Under a "standard-of-living" concept of income (assuming A and A' are both in the 25-percent rate bracket), A would give A' $1,000. After paying taxes of $250, A' would have $750 to consume. At the same time, A would deduct $1,000 from his tax base, saving $250 and making the net cost of his gift $750.

Although the effects of progressivity would alter this somewhat, it is not clear that the differences in rates between giver and receiver would be likely to be large if a lifetime view were taken. Naturally, under present law, an adult donor will tend to have a higher marginal rate of income tax than a child donee. It is for this reason that present income tax law treatment of gift and bequest transactions may come closer than the more intuitively obvious one -- excluding to donor, including to donee -- to measuring "standard-of-living" income correctly. Certain administrative aspects also favor the present treatment of gifts and bequests for income tax purposes.

In summary, whether by accident or design, present income tax law incorporates a rough sort of "standard-of-living" view of the concept of income because it does not include an extra tax on wealth transfers as an integral part of the income tax. Such treatment approximates a provision where a gift given is included in the income of the donee and excluded from the income of the donor, even though the mechanics of calculating the tax are on the opposite basis.

It is, then, mainly the estate and gift tax that introduces the "ability-to-pay" element into the tax system, because it results in a gift or bequest being taxed twice to the donor, once under the income tax and again under the transfer tax. The value implicitly expressed is that taxes should generally be assessed on a "standard-of-living" basis, except in the case of individuals whose ability to pay is very large, <u>and</u> whose standard of living is low relative to ability to pay (i.e., those who refrain from consuming in order to make gifts and bequests).

ALTERNATIVE BASES: EQUITY CONSIDERATIONS

The previous section considered what tax base is implicit in present law. In a sense, the answer itself is an equity judgment, because equity traditionally has played an important role in the tax legislation process. This section considers the relative equity claims of a "consumption" as compared with an "income" basis, <u>of either</u> "ability-to-pay" or "standard-of-living" type, and the "ability-to-pay" or "standard-of-living" version of <u>either</u> consumption or income.

<u>Consumption or Income: Which is the Better Base?</u>

Involved in the choice between consumption and income as the basis for assessing tax burdens is more than a simple subjective judgment as to whether, of two individuals having different incomes in a given period but who are identical in all respects in all other periods, the one with the higher income should pay the higher tax. Examples of tax burdens considered within a life-cycle framework suggest that a consumption base deserves careful attention if the primary consideration is fairness, whether one takes an ability-to-pay or a standard-of-living view.

Many observers consider income and consumption to be simply alternative reasonable ways to measure well-being; often, income is regarded as somewhat superior because it is a better measure of ability to pay. However, in a life-cycle context, income and consumption are not independent of each other. Of two individuals with equal earning abilities at the beginning of their lives, the one with higher consumption early in life is the one who will have a lower lifetime income. This is true because saving is not only a way of using wealth, but also a way of producing income. Thus, the person who saves early in life will have a higher lifetime income in present-value terms. Although his initial endowment of financial wealth and of future earning power is independent of the way he chooses to use it, his lifetime income is not independent of his consumption/savings decisions.

The examples presented below show that a consumption base would be more likely to maintain the same relative rankings of individuals ranked by endowment than an income base, if "endowment" is defined as an individual's wealth, in marketable and nonmarketable forms, at the beginning of his working years. Wealth so defined consists of the total monetary value of financial and physical assets on hand, the present value of future labor earnings and transfers, less the cost of earning income and less the present value of the "certain other outlays" discussed in the accounting framework above. If endowment is regarded as a good measure of ability to pay over a lifetime, this implies that a consumption base is superior to an income base as a measure of lifetime ability to pay.

If individuals consume all of their initial endowment during their lifetime (that is, leave no bequest), a consumption tax is exactly equivalent to an initial endowment tax. However, an income tax treats individuals with the same endowment differently, if they have either a different pattern of consumption over their lifetime or a different pattern of earnings.

Consider first two individuals with no initial financial or physical wealth, no bequest, the same pattern of labor earnings, and different patterns of consumption. Intuition suggests that, unless these individuals differ in some respect other than how they choose to use their available resources (e.g., with respect to medical expenses or family status), they should bear the same tax burden, measured by the present value of lifetime taxes. The tax system should not bear more heavily on the individual who chooses to purchase better food than on the one who chooses to buy higher quality clothing. Nor should it bear more heavily on the individual who chooses to apply his endowment of labor abilities to purchase of consumption late in life (by saving early in life) than it does on the one who consumes early in life.

While an income tax does not discriminate between the two taxpayers in the case where the two taxpayers consume different commodities, it does in the case where they choose to consume in different time periods in their lives. An income tax imposes a heavier burden on the individual who prefers to save for later consumption than on the one who consumes early, and the amount of difference may be significant. The reason is the double taxation of savings under an income tax. The "use" of funds for savings is taxed, and then the yield from savings is taxed again. The result is that the individual who chooses to save early for later consumption is taxed more heavily than one who consumes early.

The tax burden may be reduced most by borrowing for early consumption, since the interest cost is deducted in calculating income.

Now, suppose that the two individuals have different time paths of labor earnings but that the two paths have the same present discounted value. For example, individual A may earn $10,000 per year in a given 2-year period, while individual B works for twice as many hours and earns $19,524 in the first of the 2 years, but earns nothing in the second. (The figure of $19,524 is the total of $10,000 plus the amount that would have to be invested at a 5-percent rate of return to make $10,000 available one year later.) Each individual prefers to consume the same amount in both periods, and in the absence of tax, each would consume the same amount, $10,000 per year. Intuition suggests these two individuals should bear the same tax burden. However, under an income tax (even at a flat rate, i.e., not progressive), they would pay different taxes, with B paying more than A. The reason, again, is the double taxation of B's savings. The differences may be very large if a long time period is involved. An income tax imposes a higher burden on the individual who receives labor income earlier even though both have the same initial endowments in present-value terms and the same consumption paths.

"Standard-of-Living" or "Ability-to-Pay": Which Criterion?

Although for the vast majority of individuals bequests and gifts of cash and valuable property constitute a negligible portion of sources and an equally negligible portion of uses of funds, the tax treatment of these transactions will have significant consequences for a minority of wealthy individuals and, therefore, for the perceived fairness of the tax system.

The equity judgment embodied in present law is that large transfers should be subject to a substantial progressive tax under the estate and gift tax laws and that relatively small transfers need not be taxed. For income tax purposes, amounts given are taxed to the donor and are not taxed to the donee. This has general appeal. The usual reaction to the idea that gifts given should also be included in the tax base of the donee is that this would be an unfair double taxation.

As has been pointed out, the circumstances under which large transfers occur are relatively large wealth and low consumption of donor. The imposition of a substantial transfer tax (estate and gift tax) is consistent with a common argument for this tax; namely, that it is desirable to prevent extreme accumulations of wealth. If this is, indeed, the equity objective, it suggests that the code's present allowance of relatively large exemptions and imposition of high rates on very large transfers is sensible.

Summing Up: The Equity Comparison of Consumption and Income Bases

As a general matter, the important conclusions to be drawn from the foregoing discussion are:

- **Either an income or a consumption tax** may be designed to fulfill "ability-to-pay" or "standard-of-living" objectives. The difference is not between these two types of tax, but rather between a tax in which gifts given are considered part of the tax base of either donor or donee or, instead, part of the tax bases of both donor and donee. In the latter case, the tax embodies an "ability-to-pay" approach; in the former, the tax follows from a "standard-of-living" approach. The present income tax system expresses a "standard-of-living" basis of comparison, while the present estate and gift tax system combines with income tax to give an "ability-to-pay" approach in certain cases.

- The difference between a consumption base and an income base of either the "standard-of-living" or the "ability-to-pay" type is between one that depends upon the timing of consumption and earnings (and gifts, in the case of an "ability-to-pay" tax) during an individual's lifetime and one that does not. The income tax discriminates against people who earn early in life or prefer to consume late in life. That is, if a tax must raise a given amount of revenue, the income tax makes early earners and late consumers worse off than late earners and early consumers. A consumption tax is neutral between these two patterns.

- A consumption tax amounts to a tax on lifetime endowment. It may be viewed as an ideal wealth tax, that is, a tax that makes an assessment on lifetime wealth. An income tax will tend to assess tax burdens in a way presumably correlated with lifetime wealth, but because it depends upon matters of timing, the correspondence is nowhere near as close as would be the case under a consumption base tax.

- As previously noted, present law introduces an "ability-to-pay" element into the tax system through the estate and gift provisions. The same device is equally compatible with either an income base or a consumption base tax. As will be discussed in chapter 4, in some respects an estate and gift tax system fits more logically with a consumption base system, which allows deduction of gifts by the donor and requires inclusion by the donee.

ALTERNATIVE TAX BASES: SIMPLICITY CONSIDERATIONS

Of central importance in determining the complexity of a tax system -- to the taxpayer in complying and to the tax collector in auditing compliance -- is the ease with which the required transaction information can be assembled and the objective nature of the data. Three desirable characteristics are readily identifiable:

- Transactions should be objectively observable -- as in the case of the transaction of a wage payment. Such transactions are called "cash" transactions in this report. "Imputed" transactions, i.e., values arrived at by guesses or rules of thumb -- as in the case of depreciation -- should be kept to a minimum.

- The period over which records need to be kept should be as short as practicable.

- The code should be understandable.

Consumption or Income Preferable on Grounds of Simplicity?

With respect to simplicity criteria, the consumption base has many advantages, as can be seen on examination of the accounting relationships. At this stage, both the concept of consumption and the concept of increase in net worth must be complicated by adding imputed elements to the simple example.

The portion of consumption calculable from cash transactions includes cash outlays for goods and services and transfers to others (optional, depending upon the choice between "standard-of-living" and "ability-to-pay" versions). In addition, an individual usually obtains directly the equivalent of certain consumption services that he could purchase in the marketplace. The most important of these are the services from durable goods, such as owner-occupied houses, and household-produced services, such as child care, recreation, etc.

The change in net worth over a given time period, the other component of income, is calculable in part by cash transactions. These include such items as net deposits in savings accounts. Imputed elements, however, are extensive and lead to some of the most irksome aspects of income tax law. Among these are the change in value of assets held over the period, including the reduction in value due to wear and tear, obsolescence, etc. (depreciation); increases in value of assets due to retained earnings in corporate shares held, changed expectations about the future, or changed valuation of the future (accruing capital gains); and accruing values of claims to the future (such as pension rights, and life insurance).

Thus, both consumption and the change in net worth can be expressed as the sum of items calculable from cash transactions within the accounting period and items that must be imputed. The cash items are easy to measure, but imputed items are a source of difficulty. Because the imputed consumption elements are needed for a comprehensive income <u>or</u> consumption base, consider first some of the more significant imputed elements of the change in net worth, representing necessary <u>additions</u> to complexity if an income base is used.

Four problems commonly encountered in measuring change in net worth are depreciation, inflation adjustment, treatment of corporate retained earnings, and treatment of unrealized capital gains on nonmarketed assets.

Measurement Problems

Depreciation. Depreciation rules are necessary under an income base to account for the change in value of productive assets due to wear and tear, obsolescence, and increases in maintenance and repair costs with age. Because productive assets often are not exchanged for long periods of time, imputations of their annual change in market value must be made.

Inevitably, depreciation rules for tax accounting, as in the present code, can only approximate the actual rate of decline in the value of capital assets. Because changes in depreciation rules can benefit identifiable taxpayers, such rules become the object of political pressure groups and are sometimes used as instruments of economic policy, causing the tax base to depart even further from a true accretion concept. Thus, accelerated depreciation, at rates much faster than economic depreciation, has been allowed in some industries as a deliberate subsidy (e.g., mineral industries, real estate, and some farming). To the extent that the relationship between tax depreciation and economic depreciation varies among industries and types of capital, returns to capital investment in different industries and on different types of equipment are taxed at different effective rates. Differences in the tax treatment of capital income among industries create distortions in the allocation of resources across products and services and in the use of different types of capital in production.

Unrealized depreciation of an asset is neither added to nor subtracted from the consumption base. Thus, the time path of depreciation imputed to assets does not affect the tax base of asset owners. Adoption of a consumption base tax would automatically eliminate current tax shelters that operate by allowing depreciation in excess of economic depreciation in some industries. Alternative tax subsidies to the same industries, if adopted, would have to be much more explicit and would be easier to measure. The accidental taxation of returns to capital in different industries at different rates that arises under the current system because of imperfect knowledge of true economic depreciation rates would not occur.

Inflation Adjustment. During a period of rapid inflation, the current income tax includes inflationary gains along with real gains in the tax base. For example, an individual who buys an asset for $100 at the beginning of a year and sells it for $110 one year later has not had any increase in the purchasing power of his assets if the inflation rate is also 10 percent. Yet, under the current system he would include at least part of any gain on the sale of the asset in the sources side of his tax calculation.

An ideal income base would have to adjust for losses on existing assets, including deposits in savings banks and checking accounts, resulting from inflation. Such adjustments would pose challenging administrative problems for assets held for long periods of time. The current tax system effects a rough compromise in its treatment of "long-term capital gains" by requiring that only half of such gains be included in taxable income and by allowing no inflation deduction. (However, this treatment has been substantially modified by the minimum tax and by denial of maximum tax benefits for "earned income" if the taxpayer also has capital gains.) Dividends and interest income are taxed at the same rate as labor income even though the underlying assets may be losing real value.

A second type of inflationary problem under the current tax system is that rising nominal incomes move taxpayers into higher marginal tax brackets, and thus increase the average tax rate even when real income is not growing. Inflation will automatically raise the average tax rate in any tax system with a graduated rate structure, whether based on income, consumption, or the current partial-income base. A possible solution is some type of indexing plan, such as automatic upward adjustment of exemption levels. Because this problem does not affect the relative distribution of the tax base among individuals, it is not an issue in choosing between a consumption and an income base.

Under a consumption tax, inflation would not lead to difficulties in measuring the relative tax base among individuals because consumption in any year would be measured automatically in current dollars. A decline in the value of assets in any year because of inflation would be neither a positive nor a negative entry in the consumption base.

Treatment of Corporate Income. Given the difficulty of taxing gains in asset values as they accrue, the present corporate income tax serves the practical function of preventing individuals from reducing their taxes by accumulating income within corporations. Naturally, this is but a rough approximation of the appropriate taxation of this income and the difficulty of identifying incidence and allocation effects of this tax is well known. Under a fully consistent income tax concept, as outlined below in chapter 3, "corporation income" would be attributed to individual stockholders. This integration of the corporation and personal income taxes is desirable for a progressive income tax system because the variation among individuals in marginal tax rates makes it impossible for a uniform tax on corporate income, combined with exclusion of dividends and capital gains, to assess all individual owners at the appropriate rate. Although feasible and desirable in an income tax system, full corporate integration is sometimes regarded as posing too many challenging administrative problems. A partial integration plan that allowed corporations to deduct dividend payments and/or allowed shareholders to "gross up" dividends by an amount reflecting the corporation income tax, taking a credit for the same amount in their individual income tax calculation, would eliminate the problem of "double taxation" of corporate dividends. This could be done without introducing significant complexity into the tax code, but the problem of how to treat corporate retained earnings would remain unresolved.

Treatment of corporate income under a consistent consumption tax is simpler than under a comprehensive income tax. The corporation profits tax as such would be eliminated. Individuals would normally include in their tax base all dividends received and the value of all sales of corporate shares, and they would deduct the value of all shares purchased. There would be no need to treat receipts from sales of shares differently than other sources or to attribute undistributed corporate profits to individual shareholders.

Treatment of Unrealized Asset Value Changes. The increase in net worth due to any changes in value of assets, whether realized or not, would be included in the accretion concept of income. An individual who sells a stock at the end of the year for $100 more than the purchase price at the beginning of the year and an individual who holds a parcel of land that increases in value by $100 during the same time interval both experience the same increase in net worth.

However, unrealized asset value changes are often difficult to determine, especially if an asset has unique characteristics and has not been exchanged recently on an open market. Further, there is a question as to what is meant by the value of an asset for which the market is very thin and whether changes in the value of such assets should be viewed in the same way as an equal dollar flow of labor, interest, or dividend income. For example, if the value of an individual's house rises, he is unlikely to find it convenient to realize the gain by selling it immediately. Any tax obligation, however, must ordinarily be paid in cash.

Similar questions arise with respect to the treatment of increases in the present value of a person's potential income from selling his human services in the labor market. It is not practical to measure either the increase in an individual's wealth from a rise in the demand for his labor or the depreciation of the present value of future labor earnings with age. Present law makes no attempt to recognize such value changes nor would they be captured in the comprehensive income tax proposal presented in chapter 3.

Under a consumption tax, unrealized changes in asset value would not need to be measured because consumption from such assets does not occur unless either cash flow is generated by the asset or the asset is converted into a monetary value by sale.

Finally, the problem of income averaging can be minimized with techniques of cash flow management. Averaging is desirable under an income tax because, with a progressive rate structure, an individual with an uneven income stream will have a higher tax base than an individual with the same average income in equal annual installments. Equity requires that two individuals pay the same tax when they have the same lifetime endowment, regardless of the regularity of the pattern in which earnings are received (or expended).

The consumption tax may be viewed as a tax in the initial time period on the present value of an individual's lifetime consumption expenditures. Deferral of consumption by saving at positive interest rates raises total lifetime consumption but leaves unchanged the present value of both lifetime consumption and the tax base.

Although the annual cash flow measure of the consumption tax correctly measures the present value of lifetime consumption, averaging problems may arise if annual cash flow varies from year to year. The major averaging problem results from large irregular expenditures, such as the purchase of consumer durables. As described in chapter 4, there are two alternative ways of dealing with loans and investment assets in measuring the tax base. Both methods yield the same expected present value of the tax base over time but enable an individual to alter the timing of his recorded consumption expenditures. The availability of an alternative treatment of loans and assets enables individuals to even out their recorded pattern of consumption for tax purposes and represents a simple and effective averaging device under a consumption tax.

The same type of automatic averaging cannot be introduced under an income tax because an income tax is not a tax on the present value of lifetime consumption. Under an accretion income tax, the present value of the tax base rises when consumption is deferred, if interest earnings are positive, because the income used for saving is taxed in the year it is earned and then the interest is taxed again. Thus, allowing deferral of tax liability under an income tax permits a departure from the accretion concept, lowering the present value of tax liability.

The discussion above suggests that, contrary to popular belief, a consumption-based tax might be easier to implement, using annual accounting data in an appropriate and consistent fashion, than an income-based tax.

"Standard-of-Living" or "Ability-to-Pay" Preferable on Simplicity Grounds?

The choice between an "ability-to-pay" and a "standard-of-living" approach under the consumption or income tax has significant implications for simplicity of administration. It is relatively easy to insure that the amount of a gift is counted in the tax base of either the donor or the donee. Under present law, gifts (other than charitable gifts) are not deductible from the tax base of the donor. If gifts were deductible, the donor could be required to identify the donee. A requirement that both donor and donee be taxed, as would be implied by an "ability-to-pay" approach, would introduce a great temptation to evade. Taxing both sides would require that the gift not be deductible by the donor and that it be included in the tax base of the donee. Particularly for relatively small gifts and gifts in-kind, auditing compliance with this rule, where no evidence is provided in another person's return of having made the gift, could be a formidable problem. For much the same reason, compliance with the existing gift tax law is believed to be somewhat haphazard.

The issue of gifts in-kind is important. It is difficult to establish whether a gift has been given in these cases (e.g., loan of a car or a vacation home). Again, if the gift need only be taxed to one of the parties to the transaction, failing to report a gift simply means it is taxed to the giver and not the recipient.

Gifts in-kind are significant in another sense. Gifts and bequests can be considered a minor matter to most people only if the terms are taken to refer to transfers of cash and valuable property. If account were taken of the transfers within families that take the form of supporting children until their adulthood, often including large educational outlays, inheritance would certainly be seen to constitute a large fraction of the true wealth of many individuals. Any discussion of gifts and bequests should take into account that the parent who pays for his child's college education makes a gift no less than the parent who makes a gift of the family farm or of cash, even though this equivalence is not recognized in present tax law.

Where large gifts of cash and property are involved, it seems likely that enforcement of a double tax on transfers will be less costly than when gifts are small. This has proved to be the case under current law.

EFFICIENCY ISSUES IN A CHOICE BETWEEN AN INCOME AND A CONSUMPTION BASE

In public discussions, the efficiency of a tax system is often viewed as depending on its cost of administration and the degree of taxpayer compliance. While these features are important, one other important characteristic defines the efficiency of a tax system: As a general principle, <u>the tax system should minimize the extent to which individuals alter their economic behavior so as to avoid paying tax.</u> In other words, it is usually undesirable for taxes to influence individuals' economic decisions in the private sector. There may, of course, be exceptions where tax policies are used deliberately to either encourage or discourage certain types of activities (for example, tax incentives for installation of pollution equipment or high excise taxes on consumption of liquor and tobacco).

Both an ideal consumption tax and an ideal income tax, though neutral among commodities purchased and produced, do have important incentive effects that are unintended by-products of the need to raise revenue. Specifically, individuals can reduce their tax liability under either tax to the extent it is possible to conduct economic activities outside of the marketplace. For example, if an individual pays a mechanic to repair his automobile, the labor charge will entered into the measurement of consumption or income and will be taxed under either type of tax. On the other hand, if the individual repairs his own automobile, the labor cost will not be accompanied by a measurable transaction and will not be subject to tax. Phrased more generally, both an income and a consumption tax distort the choice between labor and leisure, where leisure is defined to include all activities, both recreational and productive, that are conducted outside the process of market exchange.

While both consumption and income taxes distort the choice between market and nonmarket activities, only an income tax distorts the choice between present and future consumption.

Under an income tax, the before-tax rate of return on investments exceeds the after-tax interest rate received by those who save to finance them. The existence of a positive market interest rate reflects the fact that society, by sacrificing a dollar's worth of consumption today and allocating the dollar's worth of resources to the production of capital goods, can increase output and consumption by more than one dollar next year. Under an income tax, the potential increase in output tomorrow to be gained by sacrificing a dollar's worth of output today exceeds the percentage return to an individual, in increased future consumption, to be derived from saving. In effect, the resources available to an individual for future consumption are double-taxed; first, when they are earned as current income and second, when interest is earned on savings. The present value of an individual's tax burden may be reduced by shifting consumption from future periods to the present.

A consumption tax, on the other hand, is neutral with respect to the choice to consume in different periods because current saving is exempted from the base. The expected present value of taxes paid is not affected by the time pattern of consumption. A switch from an income tax to an equal-yield consumption tax would thus tend to increase the fraction of national output saved and invested, and thereby raise future output and consumption.

The fact that a tax is neutral with respect to the savings-consumption decision is not, of course, decisive in its favor even on efficiency grounds. No taxes are neutral with respect to all choices. Thus, for example, it has already been pointed out that neither the income nor the consumption tax is neutral in the labor/leisure choice; that is, both reduce the incentive to work in the marketplace. Economic theorists have developed measures of the amount of damage done by nonneutrality in various forms. Although it is not possible on the basis of such research to make a definite case for one tax base over the other based on efficiency, when reasonable guesses are made about the way people react to various taxes it appears that the efficiency loss resulting from a consumption tax would be considerably smaller than that from an equal yield income tax.

The possible efficiency gains that would result from adopting a consumption base tax system relate closely to the frequently expressed concern about a deficient rate of capital formation in the United States. Switching from an income to a consumption base tax would remove a distortion that discourages capital formation by U.S. citizens, leading to a higher U.S. growth rate in the short run, and a permanently higher capital/output ratio in the long run.

SUMMING UP

The previous discussions have attempted to provide a systematic approach to the concept of income as composed of certain uses of resources by individuals. The current income tax law lacks such a unifying concept. Indeed, as has been suggested here, income as implicitly defined in current law deviates from a consistent definition of accretion income especially in that it excludes a major part of income used for savings (often in the form of accruing rights to future benefits). Eliminating savings from the tax base changes an income tax to a tax on consumption.

This chapter has considered whether there is any sound reason for considering substitution of a consumption base for the present makeshift and incomplete income base. It has been suggested that there is much to be said for this on grounds of equity; such a base would not have the drawback, characteristic of an income tax, of favoring those who consume early rather than late in life, and of taxing more heavily those whose earnings occur early rather than late in life. The argument has been made that the choice is not between a tax favoring the rich (who save) and the poor (who do not), as some misconceive the consumption tax, and a tax favoring the poor over the former rich by the use of progressive rates, as some view the income tax. The choice is between an income tax that, at each level of endowment, favors early consumers and late earners over late consumers and early earners and a consumption tax that is neutral between these two types of individuals. The relative burdens of rich and poor are determined by the degree of progressivity of the tax. Either tax is amenable to any degree of progressivity of rates.

A distinction has been drawn between a tax based on the uses of resources for the taxpayer's own benefit and one based on these uses plus the resources he gives away to others. The shorthand term adopted for the former is the "standard-of-living" approach to assigning tax burdens; for the latter, it is the "ability-to-pay" approach. It has been suggested that either a consumption or an income tax could be designed to fit either concept. Examination of current practice suggests that the basic tax -- the present income tax -- is, broadly speaking, of the "standard-of-living" type. An "ability-to-pay" element is introduced by special taxes on gifts and estates.

The next two chapters consider two different approaches to reform of the tax system. Chapter 3 contains a plan for a comprehensive income tax, and chapter 4 contains a plan for a very different tax, called a cash flow tax, which is essentially equivalent to a consumption tax. In both cases, a "standard-of-living" approach is adopted, under the assumption that a transfer tax of some sort, perhaps the existing estate and gift tax, would continue to be desirable as a complement.

Chapter 3

A MODEL COMPREHENSIVE INCOME TAX

OVERVIEW

This chapter presents a model income tax system based, as nearly as practicable, on a consistent definition of "standard-of-living" income as set forth in the previous chapter. The exceptions to strict conformity with the conceptual income definition are noted. These exceptions occur when rival considerations of efficiency or simplicity have seemed to overrule the underlying principle that all income should be taxed alike. In addition, those cases where the concept of income is not readily translated into explicit rules are noted and discussed. In every case, a specific model tax treatment, sometimes together with optional treatments, is defined and highlighted.

Purpose of the Model Tax

The purpose of the model tax is to provide a concrete basis for the discussion of fundamental tax reform and also to define a standard for the quantitative analysis presented in chapter 5. For each major issue of income tax policy, the model tax reflects a judgment of the preferred treatment. It is not claimed, however, that the model tax provides the unequivocally right answer to all the difficult issues of measurement, definition, and behavioral effects raised. The chapter does not, therefore, only advocate a particular set of provisions; it also presents discussions of alternative treatments.

Base-Broadening Objective

Alternative treatments are suggested when a change from the model tax provision clearly would not violate the basic principle that an income tax should be based on a practical measure of income, consistently defined. In some cases, alternative accounting methods or alternative means of applying tax rates may be used; and there may also be some uncertainties in the interpretation of the income concept itself. Because a low-rate, broad-based tax promises a general imrpovement in incentives, and because there are costs associated with recordkeeping and administration, there is a presumption against deductions, exemptions, and credits throughout the model tax. In particular instances, this presumption may be reversed in favor of an alternative treatment without offending the basic principle of income measurement.

Organization of Chapter 3

The first issues taken up in the chapter concern rules for a definition of income suitable as a tax base. Such rules are derived for three broad sources of household income--employee compensation, government transfer payments, and business income. The first of these is treated in the next section. The third section considers the tax treatment of government transfer payments, and the fourth section deals with problems of accounting for income from businesses. The next four sections of the chapter discuss some specific issues in the taxation of income derived from the ownership of capital. In each of these sections, the model tax is compared with the existing Federal income taxes. Next are three sections that treat issues in the definition of taxable income from all sources. These are the major "personal deductions" under the existing tax. Here, each of these items -- medical expenses, State and local taxes, charitable contributions, and casualty losses -- is considered as an issue of income measurement and economic efficiency. Following these is a brief discussion of the problems and principles of international income tax coordination. Finally, the questions of the proper unit for reporting taxable income and of appropriate adjustments for family size and other circumstances are considered. The chapter concludes with a sample model income tax form that serves as a summary of the model tax provisions.

EMPLOYEE COMPENSATION

The customary starting point for systems of income accounting is to observe the terms under which individuals agree to provide labor services to employers. In the simplest case, described in the previous chapter, the employee is paid an annual wage that is equal to his consumption plus change in net worth. However, in practice, complications usually will arise. On the one hand, the employee may have expenses associated with employment that should not be regarded as consumption. On the other hand, he may receive benefits that have an objective market value, which, in effect, represent an addition to his stated wage.

The model comprehensive income tax attempts to measure the value to the employee of all the financial terms of his employment. In general, the accounting for employee compensation is (1) wage and salary receipts, less (2) necessary employment expenses, plus (3) the value of fringe benefits. The remainder of this section discusses the measurement problems presented by items (2) and (3).

Expenses of Employment

Model Tax Treatment. The model comprehensive income tax would allow deduction from wage and salary receipts for expenses required as a condition of a particular job, such as the purchase of uniforms and tools, union dues, unreimbursed travel, and the like. No deduction would be allowed for expenditures associated with the choice of an occupation, place of employment, or place of residence, even though each of these is related to employment. The latter rule would continue the present treatment of education and commuting expenses, but would disallow moving expenses.

Inevitably, such rules are somewhat arbitrary. For example, whether commuting expenses are deemed costs of employment or consumption expenditures will depend upon whether the work trip is regarded principally as a part of one's choice of residence, i.e., the consumption of housing services, or as a part of the job choice. The guidelines followed here are that expenses should be deductible only if they vary little among individuals with the same job and are specific to the current performance of that job. As at present, regulations would be required to set reasonable limits for those expenses that may be subject to excessive variation, e.g., travel.

A Simplification Option. An option that would simplify individual recordkeeping and tax administration would be to allow deduction for employee business expenses only in excess of a specified amount. If this floor were substantially higher than expenses for the typical taxpayer, most employees would no longer need to keep detailed expense records for tax purposes. The principal disadvantage of this limitation of deductions is that it would tend to discourage somewhat the relative supply of labor to those occupations or activities that have relatively large expenses. Over time, such supply adjustments could be expected to provide compensating increases in wages to those whose taxes are increased by this provision, but the inefficiency of tax-induced occupation changes would remain.

Employer-Provided Pensions

A substantial share of the compensation of employees is in the form of the annual increase in the value of rights to future compensation upon retirement. This increase adds to the net worth of the employee, so that an annual estimate of the accretion of these rights is income under the comprehensive definition. The model tax treatment is intended as a uniform, practical means to estimate the income for tax purposes for different types of private pension plans.

The model comprehensive income tax would continue to exclude employer contributions to pension plans from the employee's tax base and to tax benefits when received. In addition, employee contributions would be deductible in the years paid. However, the earnings of pension plans would be taxed as they accrued. Liability for tax on pension plan earnings would be either upon the employer, if no assignment of rights were made to employees as the earnings accrue, or upon the employee to whom these earnings are allocated by the plan.

Types of Pension Plans. Employer-provided pension plans come in two forms -- defined-contribution and defined-benefit. The first form is essentially a mutual fund to which the employer deposits contributions on behalf of his employees. Each employee owns a percentage of the assets, and each employee's account increases by investment earnings on his share of the assets. Upon retirement, his account balance may be distributed to him as a lump sum payment or may be used to purchase an annuity. The income of any individual from such a plan is simply the contribution made by the employer on his behalf plus his share of the total earnings as they accrue.

Most pensions are of the second type, defined-benefit pensions. This is something of a misnomer because the benefit is not fully defined until retirement. It usually depends on the employee's average wage over the years of employment, the outcome of contract negotiations, etc. The employee's benefits may not vest for a number of years, so that the value to him, and the cost to his employer of his participation are an expectation that depend on the chance of his continued employment. By a strict definition of income, the annual change in the present value of expected future benefits constitutes income from the plan, since this is conceptually an annual increase in the net worth of the employee. In general, it is not possible to determine the accrued value of future benefits in such a plan without many arbitrary assumptions about the employee's future employment prospects, marital status at retirement, and similar issues.

A Practical Measurement System. As an alternative to estimating pension income as an accrual of value to the employee, the model plan would approximate such treatment through the current taxation of plan earnings and full taxation of actual benefits. If done correctly, this would be equivalent to the taxation of the increase in present value of expected future benefit as such increases accrue.

The following example illustrates the equivalence between taxation of accrued pension earnings and taxation of both pension plan earnings and benefits received.

> Mr. Jones' employer contributes $160 to his pension plan at the beginning of this year. Over the year, the contribution will earn 10 percent. Mr. Jones retires at the beginning of next year, taking his pension -- the contribution plus earnings -- in one payment. Mr. Jones' tax rate in both periods is 25 percent.

Method 1. Under a system of taxation of pensions as accrued, Mr. Jones would include the contribution in his taxable income and owe a tax of $40. The earnings of $12 on the remaining $120 would incur an additional tax liability of $3, leaving net earnings of $9. (Note that Mr. Jones could restore the pension fund to $160 only by drawing down his other savings, with a presumably equal rate of return, by the amount of the tax.) Upon retirement, Mr. Jones would receive a tax-prepaid pension distribution of $120 plus $9, or $129.

Method 2. The model tax treatment would subject only the earnings of the fund -- 10 percent of $160 -- to tax in the first year. This tax of $4 would leave net earnings of $12. Mr. Jones would then receive $172 upon retirement, but would owe tax on this full amount. The tax in this case would be $43, so that the remainder [$172 - $43 = $129] would be identical to that resulting from use of method 1, and Mr. Jones should be indifferent between the two treatments.

The method of including actual benefits has the advantage of avoiding the necessity to allocate prospective benefits among nonvested participants. Investment earnings would, however, have ambiguous ownership for the reasons mentioned above. Consequently, it would be necessary to assess a tax on the employer for that share of earnings not assigned to particular employees.

Present Law. Under present law, if an employer-provided pension plan is legally "qualified," retirement benefits are taxable to the employee only when received, not as accrued, even though contributions are deductible to the employer as they are made. The plan's investment income is tax exempt. Certain individuals are also allowed tax benefits similar to qualified pension plans under separate laws. These laws allow a limited amount of retirement saving to be deducted from income, its yield to be tax free, and its withdrawals taxable as personal income. This treatment allows an interest-free postponement of tax liability that would not exist under the model tax. Postponement introduces nonneutral tax treatment among forms of saving and investment, encourages a concentration of wealth in pension funds, and reduces the available tax base.

Social Security

Social security retirement benefits (OASI) present other problems. They are financed by a payroll tax on the first $15,300 (in 1976) of annual earnings, half of which is paid by the employer and half by the employee. The half paid by the employee is included in his tax base under the current income tax; the tax paid by the employer is not, although it is a deductible expense to the employer. Social security benefits are tax free when paid.

For an individual employee, the amount of annual accrual of prospective social security benefits is ambiguous. Actual benefits, by contrast, are readily measurable and certain. Furthermore, because participation in Social Security is mandatory, failure to tax accruals does not present the same tax neutrality problem encountered with private pensions; that is, there is no incentive to convert savings to tax-deferred forms. Consequently, the model tax base would allow deduction of employee contributions by the individual and continue to allow deduction of employer contributions by the employer, but OASI benefit payments would be subject to tax. Very low-income retired persons would be shielded from taxation by provision of a personal exemption and an additional family allowance.

Employer-Paid Health and Casualty Insurance

Issues in the tax treatment of health and casualty insurance are discussed separately below in the sections on medical expenses and casualty losses. In the case of employer-paid premiums for insurance unrelated to occupational hazards, the model tax adopts the same treatment that is recommended for individual purchase. The taxpayer would include as taxable employee compensation the value of the premiums paid on his behalf. Proceeds would not be included in income. The same model tax treatment would apply to the health insurance (Medicare) component of Social Security.

Disability Insurance

Private Plans. Under present law, employees are not required to include employer-paid disability insurance premiums in income, and, subject to a number of conditions, disability grants do not have to be included in the individual's income tax base. Under the proposed system, premiums paid into such disability plans by employers would not be taxable to employers, and employees would be allowed to deduct their own contributions, but the benefits would be taxable.

Conceptually, the premiums paid by the employer do increase the net worth of the employee by the expected value of benefits. Whether benefits are actually paid or not, this increase in net worth is income by a comprehensive definition. However, when benefits are taxable, as they would be under the model plan, the expected value of tax is approximately equal to the tax liability under a current accrual taxation system. The model tax treatment is preferred because valuing the worth of the future interests would pose insurmountable administrative difficulties.

Social Security Disability Insurance. The model tax would provide exactly the same treatment for the disability insurance portion of Social Security (DI), that is given for private plans. Accrual taxation is impractical because the annual value of accruing DI benefits is even less certain than for private plans.

Life Insurance

Term Life Insurance. There is no similar difficulty of valuation in employer provision of term life insurance. The annual value to the employee is equal to the premium paid on his behalf. Therefore, under the model tax, term life insurance premium payments made by the employer would be included in income to the employee; benefits would not be included in income. This parallels the present treatment of an individual's own purchase of term insurance, and that treatment would be continued.

Whole Life Insurance. Whole life insurance involves some additional considerations. A whole life policy represents a combination of insurance plus an option to buy further insurance. When one buys a whole life policy, or when it is purchased on his behalf, that policy may be viewed as 1 year's insurance plus an option to buy insurance for the next and subsequent years at a certain prescribed annual premium. That option value is recognized in the form of the "cash surrender value" of the policy. It represents the value, as determined by the company's actuaries, of buying back from the insured his option to continue to purchase on attractive terms. Naturally, the value of this option tends to increase over time, and it is this growth in value that represents the income associated with the policy. Dividends paid on life insurance are, in effect, only an adjustment in the premium paid -- a price reduction.

The total annual income associated with a whole life insurance policy is equal to the increase in its cash surrender value plus the value of the term insurance for that year (the term insurance premium) less the whole life premium, net of dividend. Under the comprehensive tax, insurance companies would inform each policyholder annually of this income, which would be included in the policyholder's income. This treatment is recommended whether the premium is paid by the individual or by his employer. In addition, the contribution of the employer to the annual payment of the premium would be included in income, as with term insurance.

Unemployment Compensation

Under present law, both the Federal Unemployment Tax Act (FUTA) taxes to finance the public unemployment compensation system and the unemployment compensation benefits are excluded from the income of covered employees. Following the recommended treatment of disability insurance, which has similar characteristics, the model comprehensive income tax would exclude payroll taxes from income as at present, but, unlike the present law, unemployment compensation benefits would be included in taxable income.

This treatment has two basic justifications. First, it conforms with the basic equity principle of subjecting all income to the same tax. Employed individuals would not be subject to differentially higher tax than those of equal income who derive their income from unemployment benefits. Second, by taxing earnings and unemployment benefits alike, this treatment would reduce the disincentive to seek alternative or interim employment during the period of eligibility for unemployment benefits. Again, the personal exemption and family allowance would prevent the tax from reaching very low-income persons who are receiving such benefits.

PUBLIC TRANSFER PAYMENTS

A large element of the income of many households is provided by payments or subsidies from government that are not related to contributions by, or on behalf of, the recipients. These transfer payments are presently excluded from the calculation of income for Federal taxes, despite their clear inclusion in a comprehensive definition of income.

Model Tax Treatment

The logic of including transfers in a tax base varies among transfer programs. A distinction may be made between those grants that are unrelated to the current financial circumstances of recipients, e.g., veterans' education benefits, and those that depend upon a stringent test of means, such as aid to families with dependent children. A second useful distinction is between cash grants that are readily measurable in value and publicly provided or subsidized services. The amount of income provided by these "in-kind" benefits, such as public housing, is not readily measurable.

The model income tax would include in income all cash transfer payments from government, whether determined by a test of means or not. Such payments include veterans' disability and survivor benefits, veterans' pensions, aid to families with dependent children, supplemental security income, general assistance, workmen's compensation, black lung benefits, and the subsidy element of food stamps.1/ The model tax would not require reporting the value of government-provided or subsidized services. Hence, there would be no extra tax associated with the benefits of such programs as Medicaid, veterans' health care, and public housing.

Rationale for Taxing Transfer Payments

Horizontal Equity. The principal argument for taxing transfer payments is horizontal equity. Under present law, families that are subject to tax from earnings or from taxable pensions may face the same financial circumstances before tax as others that receive transfer income. If an adequate level of exemption is provided in the design of a tax rate structure, these families would have no tax in either case. But for those whose incomes exceed the exemption level, the present treatment discriminates against the earning family. This is both an inequity and an element of work disincentive.

Those transfer payments that are not contingent on a strict means test are especially likely to supplement family incomes that are above the level of present or proposed exemptions. These programs are the various veterans' benefits, workmen's compensation, and black lung benefits.

The taxation of benefits from any government transfer program would effectively reduce benefits below the level that Congress originally intended, and restoration of these levels may require readjustment of the rates of taxation. However, with a progressive rate tax, the benefits to individual would be scaled somewhat to family circumstances and, in addition, the tax consequences of earnings and grants would be equalized.

Vertical Equity. The means-tested programs -- Aid to Families with Dependent Children, Supplemental Security Income, general assistance, Food Stamps, Medicaid, and public housing -- have rules to determine eligibility and to scale the value of benefits according to income and wealth of the recipient family. However, these rules may be based on measures of well-being that are different from those appropriate for an income tax. The rules also vary by region, and certain grants may supplement each other or be supplemented by other forms of assistance. Consequently, it is possible that families with similar financial circumstances before transfers will diverge widely after transfer payments are added. To the extent that some recipient households have total incomes that exceed the tax exemption level, inclusion of these grants in the tax base would reduce this divergence. Taxation of grants is no substitute for thorough welfare reform, but it may be regarded as a step toward reducing overlap of the various programs and of reducing regional differences in payment levels.

Valuing In-Kind Subsidies

Those programs of assistance to families that provide particular commodities or services, such as housing and medical care, present difficult administrative problems of income evaluation. One objective approximation of the income to households' from these services is the cost of providing them. This is the principle employed to value pension contributions, for example. But in the case of in-kind transfers, costs are not readily allocable to particular beneficiaries. Consider how difficult it would be to allocate costs among patients in veterans' hospitals, for example. Furthermore, because a recipient's choices regarding these services are restricted, the cost of the services may be substantially larger than the consumption (i.e., income) value to the beneficiary. The recipient family would almost certainly prefer an amount in cash equal to the cost of provision. Because of these uncertainties and because of the attendant costs of tax administration and reporting, the in-kind programs might reasonably be excluded from the tax base.

BUSINESS INCOME ACCOUNTING

Basic Accounting for Capital Income

What is meant here by "business income" is that part of the annual consumption or change in net worth of the taxpayer that derives from the ownership of property employed in private sector production. In the ordinary language of income sources, this income includes those elements called interest, rent, dividends, corporate retained earnings, proprietorship and partnership profits, and capital gains, each appropriately reduced by costs. Unfortunately, there is no generally accepted set of accounting definitions for all of these ordinary terms. An important objective of the model income tax is to outline an accounting system for property income that is at once administrable and in close conformance with a comprehensive definition of income.

It is apparent from the definition that income is an attribute of families and individuals, not of business organizations. Furthermore, it is useful analytically to think of income in terms of uses of resources, rather than receipts of claims. Nonetheless, accounting for income is most easily approached by beginning with receipts of individual business activities (or firms), then specifying adjustments for costs, and, finally, allocating income earned in each business among its claimants. The sum of such claims for all activities in which a taxpaying unit has an interest is that taxpayer's business income for purposes of the model tax.

In broad outline, accounting for business income proceeds as follows. Begin with gross receipts from the sale of goods and services during the accounting year and subtract purchases of goods and services from other firms. Next, subtract the share of income from the activity that is compensation to suppliers of labor services, generically called wages. Next, subtract a capital consumption allowance, which estimates the loss in value during the year of capital assets employed in production. The remainder is net capital income, or, simply, business income. Finally, subtract interest paid or accruing to suppliers of debt finance. The remainder is income to suppliers of equity finance, or profit. A business activity thus generates all three sources of income to households -- wages, interest, and profit.

Major problems in defining rules of income measurement for tax purposes include (1) issues of timing associated with a fixed accounting period, such as inventory valuation; (2) estimation of capital consumption, i.e., depreciation and depletion rules; and (3) imputations for nonmarket transactions, e.g., self-constructed capital assets. In each of these cases, there are no explicit market transactions within the accounting period to provide the appropriate valuations. Rules for constructing such valuations are necessarily somewhat arbitrary, but the rules described here are intended to be as faithful as possible to the concept of income.

Capital Consumption Allowances

Rules for capital consumption allowances should not be regarded as arbitrary allowances for the "recovery of capital costs." Rather, they are a measure of one aspect of annual capital cost; namely, the reduction in value of productive capital occasioned by use, deterioration, or obsolescence. Rules for estimating this cost should be subject to continuous revision to reflect new evidence on actual experience and changing technology. For machinery and equipment, the model tax would require that depreciation be estimated by means of a system similar, in some respects, to the existing Asset Depreciation Range (ADR) system but with annual adjustment of basis for increases in the general price level. The essential features of this system are (1) classification of all assets by type of activity, (2) mandatory vintage accounting, (3) a guideline annual repair allowance, (4) a specified annual depreciation rate (or permissible range) to be applied to the undepreciated balance (together with a date on which any remaining basis may be deducted) and (5) annual adjustment of basis in each account by a measure of the change in price levels. The inflation adjustment would be a factor equal to the ratio of the price level in the previous year to the current price level, each measured by a general price index. Notice that the recommended depreciation rules would establish a constant relative rate of depreciation as the "normal" depreciation method instead of straight-line depreciation, and it would disallow all other methods.

Depreciation of Structures. Depreciation of structures would be treated in a way similar to that for equipment except that prescribed depreciation rates may be made to vary over the life of a structure. For example, depreciation of *x* percent per year may be allowed for the first 5 years of an apartment building, *y* percent for the next 5 years, and so on. However, in no case would total depreciation deductions be allowed to exceed the original basis, after annual adjustment for inflation. Gains and losses would be recognized when exchanges or demolitions occur. Depreciation and repair allowance rates for exchanged properties always would be determined by the age of the structure, not by time in the hands of the new owner. Expenditures for structural additions and modifications that exceed a guideline repair allowance would be depreciated as new structures.

Depletion of Mineral Property. For mineral property capital assets include the value of the unexploited deposits in addition to depreciable productive equipment. The value of the mineral deposit depends upon its accessibility as well as the amount and quality of the mineral itself. This value may change as development proceeds, and this change in value is a component of income. The value of the deposit will be subsequently reduced, i.e., depleted, as the mineral is extracted. To measure income accurately, a depletion allowance should then be provided that is equal to the annual reduction in the value of the deposit.

Unfortunately, the value of a mineral deposit becomes known with certainty only as the mineral is extracted and sold. Its value at discovery becomes fully known only after the deposit has been fully exploited. Yet, the value on which to base a tax depletion allowance and an annual depletion schedule must be estimated from the beginning of production. Uncertainty about the amount of mineral present, the costs of extraction and marketing, and future prices of the product make estimation of annual capital consumption particularly difficult in the case of minerals. The uncertainties are especially great for fluid minerals.

An objective market estimate of the initial value of a mineral deposit prior to the onset of production is the total of expenditures for acquisition and development, other than for depreciable assets. <u>The model tax would require that all preproduction expenses be capitalized. All such expenditures</u>, except for depreciable assets, <u>would be recovered according to "cost depletion" allowances computed on the basis of initial production rates combined with guideline decline rates derived from average experience.</u> The treatment would be similar to the model tax treatment of depreciation for structures. <u>After each 5 years of experience, or upon exchange of property ownership, the value of the deposit would be reestimated and corrections made to subsequent annual allowances.</u> But, as with depreciation, total deductions are not to exceed the (inflation-adjusted) cost basis. <u>All postproduction expenditures</u>, except for depreciable assets, <u>also must be capitalized and recovered by cost depletion</u> according to the rules in effect for that year.

<u>Self-Constructed Assets</u>

Capital assets that are constructed for use by the builder, rather than for sale, are an example of a case in which a market transaction normally used in the measurement of income is missing. The selling price for a building, machine, or piece of transportation equipment constructed by one firm for sale to another helps to determine the income of the seller and, simultaneously, establishes the basis for estimating future tax depreciation and capital gain of the buyer. Income to the seller will be determined by subtracting his costs from the selling price, so that (with proper accounting for inventories over the construction period) all income generated in the construction process will have been subject to tax as accrued. However, when a construction firm builds an office building, or a shipping company a ship, for its own use or rental, no explicit transfer price is attached to that asset. If any costs associated with construction of the building or ship can be deducted currently for tax purposes, or if any incomes arising from construction can be ignored, current income is understated and a deferral of tax is accomplished.

Unrecognized income is derived from inventories of unfinished buildings, for example. An independent contractor who produces a building for sale must realize sufficient revenue from the proceeds of that sale to compensate suppliers of all capital, including capital in the form of the inventory of unfinished structures during the construction period. But, for self-constructed assets, incomes accruing to suppliers of equity during construction are not recognized for tax purposes because there is no sale. Under current law, certain construction costs, such as taxes and fees paid to governments, may be deducted as current expenses. The result of these lapses of proper income measurement is a tax incentive for self-construction and for vertical integration of production that would otherwise be uneconomic. The present treatment also encourages various arrangements to defer income taxes by providing the legal appearance of integration. These arrangements are popularly known as tax shelters.

To provide tax treatment equivalent to that of assets constructed for sale, the model tax would require that all payments for goods and services associated with construction of capital goods not for sale (including property taxes and other fees to government, depreciation of own equipment, but not interest paid) be segregated into a special account. During the construction period, a guideline rate of return would be imputed to the average value of this account and added to the income tax base of the builder and also to the depreciable basis of the assets.2/ When such assets are placed in service, they would be depreciated according to the regular rules.

Other Business Income Accounting Problems

A number of other problems of inventory valuation must be faced in order to specify a fully operational comprehensive income tax. Also, special rules would be required for several specific industries, in addition to minerals, to improve the measurement of income as compared to the present law. For example, agriculture, banking, and professional sports have presented special difficulties. This section has not spelled out all of these special rules, but has attempted to suggest that improvement of business income measurement for tax purposes is possible and desirable.

INTEGRATION OF THE INDIVIDUAL AND CORPORATION INCOME TAXES

Strictly speaking, the uses concept of income -- consumption plus change in net worth -- is an attribute of individuals or families, not of business organizations. Corporations do not consume, nor do they have a "standard of living." The term "corporate income" is shorthand for the contribution of the corporate entity to the income of its stockholders.

The Corporation Income Tax

Under existing law, income earned in corporations is taxed differently from other income. All corporate earnings are subject to the corporate income tax, and dividend distributions are also taxed separately as income to shareholders. Undistributed earnings are taxed to shareholders only as they raise the value of the common stock and only when the shareholder sells his stock. The resulting gains upon sale are taxed under the special capital gains provisions of the individual income tax. Thus, the tax on retained earnings generally is not at all closely related to the shareholder's individual tax bracket.

Subchapter S Corporations. An exception to these general rules exists for corporations that are taxed under subchapter S of the Internal Revenue Code. If a corporation has 10 (in some cases 15) or fewer shareholders and meets certain other requirements, it may elect to be taxed in a manner similar to a partnership. The income of the entity is attributed directly to the owners, so that there is no corporate income tax and retained earnings are immediately and fully subject to the individual income tax. For earnings of these corporations, then, complete integration of the corporate and individual income taxes already exists.

Inefficiency of the Corporation Income Tax

The separate taxation of income earned in corporations is responsible for a number of serious economic distortions. It raises the overall rate of taxation on earnings from capital and so produces a bias against saving and investment. It inhibits the flow of saving to corporate equities relative to other forms of investment. Finally, the separate corporate tax encourages the use of debt, relative to equity, for corporate finance.

The existing differential treatment of dividends and undistributed earnings also results in distortions. Distribution of earnings is discouraged, thus keeping corporate investment decisions from the direct test of the capital market and discouraging lower-bracket taxpayers from ownership of stock.

Owners of closely held corporations are favored relative to those that are publicly held. Owner-managers may avoid the double taxation of dividends by accounting for earnings as salaries rather than as dividends, and they may avoid high personal tax rates by retention of earnings in the corporation with eventual realization as capital gains. Provisions of the law intended to minimize these types of tax avoidance add greatly to the complexity of the law and to costs of administration.

A Model Integration Plan

In the model tax system, the corporate income tax would be eliminated, and the effect of subchapter S corporation treatment would be extended to all corporations. There are alternative methods of approximating this result. Because the direct attribution of corporate income to shareholders most nearly matches the concept of an integrated tax, a particular set of rules for direct attribution is prescribed as the model tax plan. However, there are potential administrative problems with this approach. These problems will be noted and alternative approaches described.

The model tax treatment of corporate profits may be summarized by the following four rules:

1. The holder of each share of stock on the first day of the corporation's accounting year (the "tax record date") would be designated the "shareholder of record."

2. Each shareholder of record would add to his tax base his share of the corporation's income annually. If the corporation had a loss for the year, the shareholder would subtract his share of loss.

3. The basis of the shareholder of record in his stock would be increased by his share of income and decreased by his share of loss.

4. Any shareholder's basis in his stock would be reduced, but not to below zero, by cash dividends paid to him or by the fair market value of property distributed to him. Once the shareholder's basis had been reduced to zero, the value of any further distributions would be included in income. (A distribution after the basis had been reduced to zero would indicate the shareholder had, in the past, income that was not reported.)

Designation of a shareholder of record to whom to allocate income earned in the corporation is necessary for large corporations with publicly traded stock. This treatment is designed to avoid recordkeeping problems associated with transfers of stock ownership within the tax year and to avoid "trafficking" in losses between taxpayers with different marginal rates.

Importance of the Record Date. Suppose that the record date were at the end of the taxable year when reliable estimates of the amount of corporate earnings or losses would be known. Shortly before the record date, shareholders with high marginal rates could bid away shares from shareholders with relatively low marginal rates whose corporations are expected to show a loss.

The losses for the year then would be attributed to the new shareholders for whom the offset of losses against other income results in the greatest reduction in tax liability. Thus, a late-year record date would have the effect of reducing the intended progressivity of the income tax and would bring about stock trading that is solely tax motivated.

The earlier in the tax year that the record date were placed the more the shareholder's expected tax liability would become just another element in the prediction of future returns from ownership of stock in the corporation, as is now the case under the corporation income tax. If the record date were the first day of the tax year, the tax consequences of current or corporate earnings or losses already accrued in the corporation could not be transferred to another taxpayer.

<u>Treatment of the Full-Year Shareholder</u>. Under the model tax scheme, a shareholder who holds his stock for the entire taxable year would be taxed on the full amount of income for the year (or would deduct the full amount of loss). Any gain from sale of the stock in a future year would be calculated for tax purposes by subtracting from sale proceeds the amount of his original basis plus the undistributed earnings upon which he has been subject to tax. His corporation would provide him with a statement at the end of each taxable year that informed him of his share of corporate earnings. He then could increase his basis by that amount of earnings less the sum of distributions received during the year. For full-year stockholders, then, basis would be increased by their share of taxable earnings and reduced by the amount of any distributions.

It should be noted that, under this treatment, dividends would not be considered income to the shareholder, but would be just a partial liquidation of his portfolio. Income would accrue to him as the corporation earned it, rather than as the corporation distributed it. Hence, dividend distributions would merely reduce the shareholder's basis, so that subsequent gains (or losses) realized on the sale of his stock would be calculated correctly.

<u>Treatment of a Shareholder Who Sells During the Year</u>. A shareholder of record who sells his stock before the end of the tax year would not have to wait to receive an end-of-year statement in order to calculate his tax. He simply would calculate the difference between the sale proceeds and his basis as of the date of sale. The adjustment to basis of the shareholder's stock to which he would be entitled at the time of the corporation's annual accounting would always just offset the amount of corporate income or loss that he would normally have to report as the shareholder of record. Therefore, the income of a shareholder who sold his shares would be determined fully at the time of sale, and he would have no need for the end-of-year statement.

A numerical example may be useful in explaining the equivalence of treatment of whole-year and part-year stockholders. Suppose that, as of the record date (January 1), shareholder X has a basis of $100 in his one share of stock. By June 20, the corporation has earned $10 per share, and X sells his stock for $110 to Y. The shareholder would thus realize a gain of $10 on the sale, and this would be reported as income.

To illustrate that subsequent corporate earnings would be irrelevant to the former shareholder's calculation of income for taxes, suppose the corporation earns a further $15 after the date of sale, so that as the shareholder of record X receives a report attributing $25 of income to him, entitling him to a $25 basis increase (on shares he no longer owns). One might insist that X take into his tax base the full $25 and recalculate his gain from sale. In this event, the increase in basis from $100 to $125 would convert his gain of $10 from sale to a loss of $15 (adjusted basis = $125; sale price = $110). The $15 loss, netted against $25 of corporate income attributed to him as the shareholder of record, yields $10 as his income to be reported for tax, the same outcome as a simple calculation of his gain at the time of sale. The equivalence between these two approaches may not be complete, however, if the date of sale and the corporate accounting occur in different taxable years. Nonetheless, in the case cited, the model plan appears superior in the simplicity of its calculations, in allowing the taxpayer to know immediately the tax consequences of his transactions, and in its better approximation to taxing income as it is accrued.

In the event there had been a dividend distribution to X of the $10 of earnings before he sold, this distribution would be reflected in the value of the stock, which would now command a market price of $100 on June 20. The amount of the dividend also would reduce his basis to $90, so that his gain for tax purposes would be $10, just as before. The dividend per se has no tax consequences. At the end of the year he again would be allocated $25 of corporation income, but, as before, an offsetting increase in basis. Thus, he will not report any income other than his gain on the sale of the share on June 20.

Note that the same result would obtain in this case if the shareholder included the dividend in income but did not reduce his basis. There would then be $10 attributable to the dividend and no gain on the sale. This treatment of dividends in the income calculation gives correct results for the shareholder who disposes of his shares. However, it would attribute income to a purchaser receiving dividends before the next record date even though such distributions would represent merely a change in portfolio composition. This approach (all distributions are taken into the tax base with only retained earnings allocated to record date shareholders and giving rise to basis adjustments) might, nevertheless be considered an alternative to the treatment of the model plan because it is more familiar and would involve fewer basis adjustments and hence a reduced record-keeping burden. The substance of the full integration proposal would be preserved in this alternative treatment.

The proposed full integration system would make it possible to tax income according to the circumstances of families who earn it, regardless of whether income derives from labor or capital services, regardless of the legal form in which capital is employed, and regardless of whether income earned in corporations is retained or distributed. To the extent that retained earnings increase the value of corporate stock, this system would have the effect of taxing capital gains from ownership of corporate stock as they accrued, thereby eliminating a major source of controversy and complexity in the present law.

Administrative Problems of Model Tax Integration

The Liquidity Problem. Some problems of administration of the system just described would remain. One such problem is that income would be attributed to corporate shareholders whether or not it actually was distributed. To the extent the corporation retained its earnings, the shareholders would incur a current tax liability that must be paid in cash, even though their increases in net worth would not be immediately available to them in the form of cash. Taxpayers with relatively small current cash incomes might then be induced to trade for stocks that had higher rates of dividend payout to assure themselves sufficient cash flow to pay the tax.

Imposition of a withholding tax at the corporate level would help to reduce this liquidity problem and perhaps also reduce the cost of enforcement of timely collections of the tax.

One method of withholding that is compatible with the model tax method for assigning tax liabilities is to require corporations to remit an estimated flat-rate withholding tax at regular intervals during the tax year. This tax would be withheld on behalf of stockholders of record. Stockholders of record would report their total incomes, including all attributed earnings, but also would be allowed a credit for their share of taxes withheld. Taxpayers who hold a stock throughout the entire year would receive one additional piece of tax information from the corporation -- the amount of their share of tax withheld throughout the year -- and would subtract the tax withheld as a credit against their individual liability.

This withholding system would complicate somewhat the taxation of part-year stockholders. As explained above, the taxable income of the corporation attributed to stockholders could be determined fully at the time of sale as the sum of dividends received during the year and excess of sale price over basis that existed on the record date. However, if withholding were always attributed to the shareholder of record, he would be required to wait until corporate income for the year had been determined to know the amount of his tax credit for withholding during the full tax year. The selling price of the stock may be expected to reflect the estimated value of this prospective credit in the same way that share prices reflect estimates of future profits. But, in this case, the seller who was a stockholder of record would retain an interest in the future earnings of the corporation, because the earnings would determine tax credit entitlement to the end of the tax year. Despite this apparent drawback, such corporate-level withholding would insure sufficient liquidity to pay the tax, except in cases where the combination of distributions and withheld taxes is less than the amount of tax due from the shareholder of record.

Audit Adjustment Problem. Another administrative problem could arise because of audit adjustments to corporate income, which may extend well beyond the taxable year. This would appear to require reopening the returns of shareholders of earlier record dates, possibly long after shares have been sold. In the present system, changes in corporate income and tax liability arising from the audit process are borne by shareholders at the time of the adjustment. Precisely this principle would apply in the model plan. Changes in income discovered in audit, including possible interest or other penalties, would be treated like all other income and attributed to shareholders in the year the issue is resolved. Naturally, shares exchanged before such resolutions but after the matter is publicly known would reflect the anticipated outcome.

Deferral Problem. There are also some equity considerations. A deferral of tax on a portion of corporate income may occur in a year when shares are purchased. The buyer would not be required to report income earned after the date of purchase but before the end of the taxable year. All earnings in the year of sale that were not reflected in the purchase price would escape tax until the buyer sells the stock.

The 1975 Administration Proposal for Integration

In the context of a thorough revision of the income tax, integration of the corporate and personal tax takes on particular importance. The model tax plan has provisions designed to assure that the various forms of business income bear the same tax, as nearly as possible. If incomes from ownership of corporate equities are subject to greater, or lesser, tax relative to incomes from unincorporated business pension funds, or bonds, the economic distortions would be concentrated on the corporate sector. For this reason, a specific plan for attributing to stockholders the whole earnings of corporations has been presented here in some detail.

A significant movement in the direction of removing the distortions caused by the separate corporation income tax would be accomplished by the dividend integration plan proposed by the Administration in 1975. That proposal may be regarded as both an improvement in the present code, in the absence of comprehensive tax reform, and as a major step in the transition to a full integration of the income taxes, such as the model tax.

CAPITAL GAINS AND LOSSES

Capital gains appear to be different from most other sources of income because realization of gains involves two distinct transactions -- the acquisition and the disposition of property -- and each transaction occurs at a different time. This difference raises several issues of income measurement and taxation under an income tax.

Accrual Versus Realization

The first issue is whether income (or loss) ought to be reported annually on the basis of changes in market values of assets -- the accrual concept -- or only when realized. The annual change in market value of one's assets constitutes a change in net worth and, therefore, constitutes income under the "uses" definition. If tax consequences may be postponed until later disposition of an asset, there is a deferral of taxes, which represents a loss to the government and a gain to the taxpayer. The value of this gain is the amount of interest on the deferred taxes for the period of deferral. Distinct from, but closely related to, the issue of deferral is the issue of the appropriate marginal tax rate to be applied to capital gains. If capital gains are to be subject to tax only when realized, there may be a substantial difference between the applicable marginal tax rate during the period of accrual and that faced by the taxpayer upon realization. Also, the extent to which adjustment should be made for general price inflation over the holding period of an asset must be considered. Finally, the desirability of simplicity in the tax system, ease of administration, and public acceptability are important considerations.

The range of possible tax treatments for capital gains can be summarized in an array that ranges from the taxation of accrued gains at ordinary rates to the complete exclusion of capital gains from income subject to taxation. Alternatives within the range may be modified to allow for (a) income averaging to minimize extra taxes resulting from the bunching of capital gains and (b) adjustments to reflect changes in the general price level.

Present Treatment of Capital Gains

Present treatment for individuals is to tax gains when realized, at preferential rates, with no penalty for deferral. There are a number of special provisions. When those assets defined in the code as "capital assets" have been held for 6 months or more,3/ gains from their realization are considered "long-term" and receive special tax treatment in two respects: one-half of capital gains is excluded from taxable income, and individuals have the option of calculating the tax at the rate of 25 percent on the first $50,000 of capital gains. There are complex restrictions on the netting out of short- and long-term gains and losses, and a ceiling of $1,000 4/ is imposed on the amount of net capital losses that may be used to offset ordinary income in any 1 year, with unlimited carryforward of such losses. Also, there are provisions in the minimum tax for tax preferences that limit the extent to which the capital gains provisions can be used to reduce taxes below ordinary rates and that deny the use of the 50-percent maximum tax on earned income by the amount of such preferences. Limited averaging over a 5-year period is allowed for capital gains as well as for most other types of income.

There are many other capital gains provisions in the tax law that (1) define what items may be considered capital assets, (2) specify when they are to be considered realized, (3) provide for recapture of artificial accounting gains, and (4) make special provisions for timber and certain agricultural receipts. There also are special provisions that allow deferral of capital gains tax on the sale or exchange of personal residences. Much of the complexity of the tax code derives from the necessity of spelling out just when income can and cannot receive capital gains treatment.

Model Tax Treatment of Capital Gains

Under the model income tax, capital gains would be subject to full taxation upon realization at ordinary rates after (1) adjustment to basis of corporate stock for retained earnings (as explained in the integration proposal) and (2) adjustment to basis for general price inflation. Capital losses could be subtracted in full from positive elements of income to determine the base of tax, but there would be no refund for losses that reduce taxable incomes below zero. Adjustment for inflation would be accomplished by multiplying the cost basis of the asset by the ratio of the consumer price index in the year of purchase to the same index in the year of sale. These ratios would be provided in the form of a table accompanying the capital gains schedule. Table 1 is an example of such a table. (Note that for the last 3 years, the ratios are given monthly. This is to discourage December 31 purchases coupled with January 1 sales.) No inflation adjustment would be allowed for intra-year purchases and sales.

Table 1

Inflation Adjustment Factors
(Consumer Price Index based on December, 1975)

1930	3.326	1940	3.960	1950	2.307	1960	1.875	1970	1.430
1931	3.647	1941	3.771	1951	2.138	1961	1.856	1971	1.371
1932	4.066	1942	3.408	1952	2.092	1962	1.836	1972	1.327
1933	4.286	1943	3.210	1953	2.076	1963	1.814		
1934	4.147	1944	3.156	1954	2.066	1964	1.790		
1935	4.046	1945	3.085	1955	2.074	1965	1.760		
1936	4.007	1946	2.843	1956	2.043	1966	1.711		
1937	3.867	1947	2.486	1957	1.973	1967	1.663		
1938	3.941	1948	2.307	1958	1.920	1968	1.596		
1939	3.998	1949	2.329	1959	1.905	1969	1.515		

	1973	1974	1975
January	1.302	1.190	1.065
February	1.293	1.175	1.058
March	1.281	1.162	1.054
April	1.272	1.156	1.049
May	1.265	1.143	1.044
June	1.256	1.133	1.035
July	1.253	1.124	1.025
August	1.231	1.109	1.021
September	1.227	1.096	1.017
October	1.217	1.087	1.101
November	1.209	1.078	1.004
December	1.201	1.070	1.000

Source:
Office of the Secretary of the Treasury
Office of Tax Analysis, September 28, 1976

Capital Losses

With adequate adjustment for inflation, and for depreciation in the case of physical assets, capital losses under the model tax should measure real reductions in the current income of the taxpayer. There is, consequently, no reason to limit the deduction of such losses, as in current law. A forced postponement of the realization of such losses would be like requiring the taxpayer to make an interest-free loan to the government. Of course, some asymmetry in the treatment of gains relative to losses would remain, because taxpayers could benefit by holding gains to defer taxes but could always take tax-reducing losses immediately.

Taxation of Accruals in the Model Tax

Corporate Stock. As just described, the model tax would continue the present practice of recognizing income from increases in the value of capital assets only upon sale or exchange, but some income sources that presently are treated as capital gains would be put on an annual accrual basis.

If the individual and corporate income taxes were fully integrated into a single tax so that shareholders are currently taxed on retained earnings, a large portion of capital gains -- the changes in value of common stock that reflect retention of earnings -- would be subject to tax as accrued. The remainder of gains would be subject to tax only as realized. These gains would include changes in stock prices that reflect expectations about future earnings, and also changes in the value of other assets, such as bonds, commodities, and land.

Physical Assets. Depreciable assets, such as machinery and buildings, are also subject to price variations, but these variations would be anticipated, as nearly as possible, by the inflation adjustment and the depreciation allowance. If these allowances were perfectly accurate measures of the change in value of such assets, income would be measured correctly as it accrues, and sales prices would always match the remaining basis. Apparent capital gains on physical assets may, therefore, be regarded as evidence of failure to accurately measure past income from ownership of the asset. Consequently, if under the model tax, depreciation would be measured more accurately, the problem of tax deferral due to taxation of capital gains at realization would be further reduced. However, as in the case of corporate stock, some unaccounted-for variation in asset prices undoubtedly will occur despite improvements in rules for adjustments to basis. Sales of depreciable assets will, therefore, continue to give rise to taxable gains and losses. Such gains and losses are the difference between sales price and basis, adjusted for depreciation allowances and inflation.

The taxation of capital gains on a realization basis would produce significantly different results than current taxation of accrual of these gains. Even if capital gains were taxed as ordinary income (no exclusion, no alternative rate), the effective tax rate on gains held for long periods of time but subject to a flat marginal rate would be much lower than the nominal or statutory rate applied to the gains as if they accrued ratably over the period the asset was held. This consequence of deferral of tax is shown in Table 2 for an assumed before-tax rate of return of 12 percent on alternative assets yielding an annually taxable income. Each item in the table is the percent by which the before-tax rate of return is reduced by the imposition of the tax at the time of realization.

Table 2

Effective Tax Rates on Capital Gains

Taxed as Realized at Ordinary Rates

	Holding Period			
	1 year	5 years	25 years	50 years
Statutory rate of 50 percent	50%	44%	23%	13%
Statutory rate of 25 percent	25%	21%	10%	5%

Accrual Taxation Alternative

Accrual taxation of capital gains poses three problems that, taken together, appear to be insurmountable. These are (1) the administrative burden of annual reporting; (2) the difficulty and cost of determining asset values annually; and (3) the potential hardship of obtaining the funds to pay taxes on accrued but unrealized gains. Under accrual taxation, the taxpayer would have to compute the gain or loss on each of his assets annually. For common stock and other publicly traded securities, there would be little cost or difficulty associated with obtaining year-end valuations. But for other assets, the costs and problems of evaluation would be very formidable, and the enforcement problems would be substantial. It would be very difficult and expensive to valuate assets by appraisal; valuation by concrete transactions, which taxing realizations would provide, has distinct advantages.

For taxpayers with little cash or low money incomes relative to the size of their accrued but unrealized capital gains, accrual taxation may pose cash flow problems. This circumstance is similar to that encountered with local property taxes assessed on homeowners. There is no cash income associated with the asset in the year that the tax liability is owed. However, in cases of potential hardship certain taxpayers could be allowed to pay a later tax on capital gains, with interest, at the time a gain is realized.

Realization-With-Interest Alternative

An alternative method that attempts to achieve the same economic effect as accrual taxation is taxation of capital gains at realization with an interest charge for deferral. But, in addition to the present complex rules defining realizations that would not be avoided in the model tax plan, rules would be required for the computation of interest on the deferred taxes. An appropriate rate of interest would have to be determined and some assumption made about the "typical" pattern of accruals. In order to eliminate economic inefficiency, the interest rate on the deferral should be the individual taxpayer's rate of return on his investments. However, because it is impossible to administer a program based on each investor's marginal rate of return, the government would have to charge a single interest rate. The single interest rate would itself tend to move alternatives away from neutrality. Moreover, for simplicity, it would have to be assumed that the gain cccurred equally over the period or that the asset's value changed at a constant rate. This assumption would be particularly inappropriate in those cases where basis was changed frequently by inflation adjustments, depreciation allowances, capital improvements, etc. Because a simple time pattern of value change would reflect reality in very few cases, the deferral charge would introduce additional investment distortions. To the extent that gains occur early in the holding period, capital gains would be undertaxed; when gains occur late in the period, capital gains would be overtaxed.

The Income Averaging Problem

Under a progressive income tax system, the tax rate on a marginal addition to income differs depending on the taxpayer's other income. Generally, the higher the income level, the higher the tax rate. Similarly, under a progressive tax system, people with fluctuating incomes pay tax at a higher average rate over time on the same amount of total income than do those persons whose incomes are more nearly uniform over time.

Clearly, if a taxpayer's income (apart from any capital gains) is rising over time, the longer he delays realization, the higher his tax rate will be. Similarly, if he realizes gains only occasionally, his gains will tend to be larger, and the average tax rate on the gains will be increased. The bunching problem could be solved by spreading the gain, via income averaging, over the holding period of the asset. This flexibility would involve great complexity, but the result could be approximated reasonably well by a fixed-period averaging system similar to the general 5-year averaging system or the special 10-year averaging system for lump sum distributions, both of which are in present law.

The problem of postponement of tax to periods of higher marginal rates is a more difficult one. One optional solution would be to calculate an average marginal tax rate over a fixed number of years and to modify the amount of gain included in the tax base for the year of realization to reflect the ratio of the average marginal rate over the period to the marginal rate in the current year. Thus, if the current rate were higher, some of the gain could be excluded from income; if the current rate were lower, more than 100 percent of the gain would be included. As is the case with charges of interest for deferral, however, such systems would add significantly to the complexity of the tax law, and represent inexact adjustments besides.

Inflation Adjustment

The proper tax treatment of capital gains is further complicated by general price inflation. Capital gains that merely reflect increases in the general price level are illusory. For example, suppose an individual's capital assets increase in value, but at a rate precisely equal to the rise in the cost of living. His net worth will not have increased in real terms, and neither, therefore, will his standard of living. If no basis adjustment is made to account for inflation, the reported capital gain for an asset held over a period of time will largely reflect the level of prices in previous years. This contrasts with other income flows, such as salaries, that are always accounted for in current dollars.

Accounting for other transactions that are affected by inflation, such as borrowing and lending, is largely corrected for anticipated inflation by market adjustments. For example, a lender will insist on a higher interest rate to compensate for taxes against the depreciating value of the principal. Therefore, an adjustment of basis for inflation is desirable in the case of ownership of capital assets to avoid overtaxation of capital gains relative to other income sources, even if general indexing of income sources and/or tax rates is not prescribed.

Inflation adjustment would introduce additional complexity. The basis for each asset would have to be revised annually, whether sold or not. For this reason, it might be desirable to restrict the inflation adjustment to those years in which the inflation rate exceeds some "normal" amount, such as 2 or 3 percent.

Clearly, there are competing objectives of simplicity, equity, and economic efficiency involved in the tax treatment of capital gains. In this case, the model tax treatment would favor simplicity by foregoing accrual treatment that would require annual valuation of all assets, or interest charges for deferral. On the other hand, clear moves in the direction of accrual taxation are taken by introducing current taxation of corporate-retained earnings and more accurate measurement of depreciation. Annual adjustment of basis for general inflation also is judged to be worth the additional administration and compliance cost.

STATE AND LOCAL BOND INTEREST

The annual receipt or accrual of interest on State and local obligations unquestionably increases the taxpayer's opportunity to consume, add to wealth, or make gifts. It is, therefore, properly regarded as a source of income. However, such interest is not included in income under current law; this is not to say that owners of such bonds bear no consequence of the present income tax. Long-term tax-exempt bonds yield approximately 30 percent less than fully taxable bonds of equal risk -- a consequence that may be regarded as an implicit tax. However, because problems of equity and inefficiency remain, this lower yield on tax-exempt bonds does not substitute for full taxation. Under the model income tax, interest on State and local bonds would be fully taxable.

Inefficiency of Interest Exclusion

The difference in interest costs that the State or local government would have to pay on taxable bonds and that which they actually pay on tax-exempt bonds is borne by the Federal Government in the form of reduced revenues. The subsidy is inefficient in that the total cost to the Federal Government exceeds the value of the subsidy to the State and local governments in the form of lower interest payments. Estimates of the fraction of the total Federal revenue loss that is not received by the State and local governments vary widely, but the best estimates seem to be in the 25- to 30-percent range.

Inequity of the Exclusion

The subsidy also may be regarded as inequitable. The value of the tax exemption depends on the investor's marginal tax rate. Thus, higher-income taxpayers are more willing than lower-income individuals to pay more for tax-exempt securities. The concentration of the tax savings among the relatively well-off reduces the progressivity of the Federal income tax as compared with the nominal rate structure. The exemption also results in differential rates of taxation among higher-income taxpayers who have incomes from different sources. Investors who would otherwise be subject to marginal rates above 30 percent may avoid these rates by purchasing tax-exempt bonds. Those with equal incomes from salaries or from active management of business must pay higher rates.

Alternatives to Tax-Exempt Bonds

The taxation of interest from State and local bonds would present no special administrative problems, except for transition rules, but alternative means of fiscal assistance to State and local governments may be desirable. Among the alternatives that have been suggested are replacement of the tax exclusion with a direct cash subsidy from the Federal Government (as under revenue sharing), or replacement with a direct interest subsidy on taxable bonds issued by State and local governments at their option. The mechanism for an interest subsidy may be either a direct Federal payment or a federally sponsored bank empowered to buy low-yield State and local bonds and issue its own fully taxable bonds.

OWNER-OCCUPIED HOUSING

Under present law, homeowners are allowed personal deductions for mortgage interest paid and for State and local property taxes assessed against their homes. Furthermore, there is no attempt to attribute to owner-occupiers the income implied by ownership of housing equity. (In the aggregate, this is estimated in the national income and product accounts at $11.1 billion per year, an amount that does not include untaxed increases in housing values.)

Imputed Rental Income

Any dwelling, whether owner-occupied or rented, is an asset that yields a flow of services over its economic lifetime. The value of this service flow for any time period represents a portion of the market rental value of the dwelling. For rental housing, there is a monthly contractual payment (rent) from tenant to landlord for the services of the dwelling. In a market equilibrium, these rental payments must be greater than the maintenance expenses, related taxes, and depreciation, if any. The difference between these continuing costs and the market rental may be referred to as the "net income" generated by the housing unit.

An owner-occupier may be thought of as a landlord who rents to himself. On his books of account will also appear maintenance expenses and taxes, and he will equally experience depreciation in the value of his housing asset. What do not appear are, on the sources side, receipts of rental payment and, on the uses side, net income from the dwelling. Viewed from the sources side, this amount may be regarded as the reward that the owner of the dwelling accepts in-kind, instead of the financial reward he could obtain by renting to someone other than himself. Since a potential owner-occupier faces an array of opportunities for the investment of his funds, including in housing for rental to himself or others, the value of the reward in-kind must be at least the equal of these financial alternatives. Indeed, this fact provides a possible method for approximating the flow of consumption he receives, constituting a portion of the value of his consumption services. Knowing the cost of the asset and its depreciation schedule, one could estimate the reward necessary to induce the owner-occupier to rent to himself.

In practice, to tax this form of imputed income, however desirable it might be from the standpoint of equity or of obtaining neutrality between owning and renting, would severely complicate tax compliance and administration. Because the owner-occupier does not explicitly make a rental payment to himself, the value of the current use of his house is not revealed. Even if market rental were estimated, perhaps as a fixed share of assessed value of the dwelling, 5/ the taxpayer would face the difficulties of accounting for annual maintenance and depreciation to determine his net income.

The present tax system does not attempt to tax the imputed income from housing. This is, perhaps, because there would be extreme administrative difficulties in determining it and because there is a general lack of understanding of its nature. The incentive for home ownership that results from including net income from rental housing in the tax base while excluding it for owner-occupied housing also has strong political support, although the result is clearly a distortion from the pattern of consumer housing choices that would otherwise prevail. Primarily for the sake of simplification, <u>the model plan continues to exclude from the tax base the portion of housing consumption attributable to owner-occupied dwellings. No imputation of the net income arising from these assets is proposed</u>.

<u>Deductibility of Homeowners' Property Tax</u>

Present law allows the homeowner to deduct State and local property taxes assessed against the value of his house as well as interest paid on his mortgage. The appropriateness of each of these deductions is considered next, beginning with the property tax.

The model tax would allow no deduction for the local property tax on owner-occupied homes or on other types of property that also have tax-free rental values, e.g., automobiles. This treatment is based on the proposition that deduction of the property tax results in further understatement of income in the tax base, in addition to the exclusion of net rental income. This cannot be justified, as can the exclusion of net income from the dwelling, on grounds of measurement difficulty. Allowing the deduction of property taxes by owner-occupiers results in unnecessary discrimination against tenants of rental housing. Elimination of the deduction would simplify tax administration and compliance and reduce the tax bias in favor of housing investment in general, and owner-occupancy in particular.

Local housing market adjustments normally will insure that changes in property taxes will be reflected in rental values. When the local property tax is increased throughout a market area, the current cost of supplying rental housing increases by the amount of the tax increase. Over time, housing supplies within the area will be reduced (and prices increased) until all current costs are again met and a normal return accrues to owners of equity and suppliers of mortgages. Accordingly, rents eventually must rise dollar-for-dollar with an increase in property tax. (Note that, in a equilibrium market, deductibility of the local tax against Federal income tax would not result in reduced Federal liability for landlords because the increase in gross receipts would match the increased deduction.) Tenants will experience an increase in rent and no change in their income tax liability.

Owner-occupiers provide the same service as landlords, and, therefore, must receive the same rental for a dwelling of equal quality. Hence, market rentals for their homes also would rise by the amount of any general property tax increase. If owner-occupiers were allowed to deduct the tax increase from taxable income while not reporting the increased imputed rent, they would enjoy a reduction in income tax that is not available either to tenants or to landlords.

To summarize the effect of the property tax increase, the landlord would have the same net income and no change in income tax; the tenant would have no change in income tax and higher rent; and the owner-occupier would have higher (imputed) rent as a "tenant," but the same net income and a reduction in his income tax as a "landlord." He would be favored relative to the renter first by receiving income from assets free of tax, and, in addition, his advantage over the tenant and landlord would increase with higher rates of local property tax. This advantage would not be present if the property tax deduction were denied to the owner-occupier. He would be treated as the tenant/landlord that he is -- paying higher rent to himself to cover the property tax while his net income and income tax were unchanged.

Deductibility of Mortgage Interest

The mortgage interest deduction for owner-occupiers is often discussed in the same terms as the foregoing property tax argument. There are, however, quite significant differences, and, because of these, the model tax treatment would continue to allow deductibility of home mortgage interest.

The effect of this policy may be equated to allowing any taxpayer to enjoy tax-free the value of consumption services directly produced by a house (or other similar asset), regardless of the method he uses to finance the purchase of this asset. The tax-free income allowed is thus the same whether he chooses to purchase the asset out of funds previously accumulated or to obtain a mortgage loan for the purpose.

This position is based on the reasoning that, given the preliminary decision (based on measurement difficulty) not be attempt to tax the net income received from his house by the person who purchases it with previously accumulated or inherited funds, it would be unfair to deny a similar privilege to those who must borrow to finance the purchase.

There is a related reason in favor of allowing the mortgage interest deduction, having to do with the difficulty of tracing the source of funds for purchase of an asset.

Prospective homeowners of little wealth are obliged to offer the house as security to obtain debt financing. By contrast, an individual of greater wealth could simply borrow against some other securities, use the proceeds to purchase housing equity, and take the normal interest deduction. In other words, a mortgage is not the only way to borrow to finance housing, and it is very difficult, if not impossible, to correlate the proceeds of any other loan with the acquisition of a house.

Nevertheless, a case may be made for disallowing interest deduction for borrowing identifiably for the purpose of financing an owner-occupied home (or other consumer durable). There is no doubt that most people finance home purchases with a mortgage using the home as security. Mortgage interest payments are surely highly correlated with net income produced by the associated housing, and denying the deduction would increase the tax base by an amount equal to a significant fraction of the aggregate net income from owner-occupied dwellings. For those who cannot otherwise finance home purchases, it would end the tax bias against renting. These considerations deserve to be weighed against the view taken here that the efficiency and equity gains from denying the mortgage interest deduction are insufficient to counterbalance the equity losses and the increased administrative complexity of the necessary rules for tracing the sources of funds.

Consumer Durables

Precisely the same arguments that have been made concerning houses also apply to consumer durables, such as automobiles, boats, and recreational vehicles. These assets generate imputed incomes and may be subject to State and local personal property taxes. The model tax would treat these assets in the same way. That is, property tax assessed against consumer durables would not be deductible, but all interest payments, including those related to purchase of durables, would be allowed as deductions.

MEDICAL EXPENSES

The present tax law allows the deduction of uninsured medical expenses, in excess of a floor, and partial deduction for medical insurance premiums. The principal argument for deductibility is that medical expenses are not voluntary consumption. Rather, they are extraordinary outlays that should not be included in the consumption component of the income definition.

Opponents of deductibility can cite a fairly high degree of "consumer choice" in the extent, type, and quality of medical services that may be elected by persons of similar health. At the extreme, health care choices include cosmetic surgery, fitness programs at resorts and spas, frequent physical examinations, and other expenditures that are not clearly distinguishable from ordinary consumption. The remainder of medical expenditures is generally insurable, and insurance premiums may be regarded as regular, predictable consumption expenditures. Indeed, tax deductibility of medical expenses may be viewed itself as a type of medical insurance that is inadequate in amount for most taxpayers and has some quite unsatisfactory features.

Model Tax Treatment

The model tax would not allow deductions for medical expenses or medical insurance premiums. The benefits of medical insurance would not be included in income. Nondeductibility of medical expenses would simplify the tax law as well as recordkeeping for households. It also would eliminate the necessity of making the sometimes difficult administrative determination of eligibility of a medical expense for deduction.

An optional treatment is presented here that would provide a refundable tax credit for a taxed share of large medical expenses. This optional approach is intended as an explicit medical insurance program, administered under the tax law. There is a presumption here, however, that administration of such a program by the tax authorities would be preferred to other alternatives.

"Tax Insurance" Under Present Law

Under present law, eligible medical expenses in excess of 3 percent of adjusted gross income (AGI) are partially reimbursed by "tax insurance" equal to the deductible expenses multiplied by the taxpayer's marginal tax rate, e.g., 25 percent. The taxpayer pays only the coinsurance rate, in this example 75 percent, times the medical expenses. Therefore, itemizers are uninsured (by the tax system) for medical expenses up to an amount that varies in proportion to their income, and above that amount they pay a coinsurance rate that decreases as marginal tax rates increase. Low-income taxpayers are more likely to exceed the floor on deductibility (3 percent of AGI), but higher-income taxpayers receive a higher rate of insurance subsidy.

A family with $10,000 of salary receipts might be at the 19-percent marginal tax rate, and thus have a "tax insurance" policy that requires that family to pay 81 percent of medical expenses in excess of $300 per year. A family with $50,000 of salary at the 48-percent marginal rate has a "policy" that requires payment of only 52 percent of expenses above $1,500 per year. The same type of tax insurance is provided for medicines and drugs to the extent that they exceed 1 percent of AGI.

Present law also allows deduction of half of private insurance premiums (up to a deduction limit of $150) without regard to the floor, the balance being treated as uninsured medical expenses subject to the 3-percent floor. Insurance proceeds are not taxable so long as they do not exceed actual expenses. In the case of fully insured expenses, the result is the same as including all insurance proceeds in income, allowing deduction of all outlays without floor, and allowing deduction for a share of premiums as well. Hence, total medical costs -- insurance premiums plus uninsured losses -- are partially deductible without floor to the extent of insurance coverage and fully deductible above a floor for the uninsured portion. Those who cannot itemize have no "tax insurance," while itemizers pay a coinsurance rate -- ranging from 30 percent to 86 percent -- that varies inversely with income.

Optional Catastrophe Insurance Provision

Viewed as a mandatory government insurance program, the present tax treatment of medical expenses deserves reconsideration. One alternative is a policy that would provide a subsidy -- either in the form of a refundable tax credit or direct appropriation -- for very large medical expenses. Under such a scheme, the floor for the deduction would be raised, but the "coinsurance" rate would be increased for all taxpayers and made uniform, rather than dependent on the taxpayer's marginal rate. For example, if a tax credit were used, its amount might be equal to 80 percent of expenses in excess of a flat floor, say, $1,000 per year. Alternatively, the floor amount might be made a share of income.

While a catastrophe insurance provision would be a major change in the system of financing medical care, it need not have a large budgetary consequence when combined with repeal of the present deductions. For the level of medical expenses prevailing in 1975, elimination of the present deduction for premiums and expenses would finance complete reimbursement of all medical expenditures that exceed 10 percent of AGI. Full reimbursement would, however, have the undesirable effect of eliminating the market incentives to restrain medical costs. Some rate of coinsurance is desirable to help ration medical resources. Supplemental private insurance would undoubtedly be made available for insurable medical expenses not reimbursed by the tax credit. No deduction would be allowed for private medical insurance premiums, but proceeds would not be taxable.

STATE AND LOCAL TAXES

The way State and local government should be treated in a comprehensive income measurement system presents difficult conceptual problems. These units might be treated simply as the collective agencies of their citizens. Ideally, in this view, the value of consumption services provided in-kind to the members of the group would be attributed to the individuals and counted on the uses side of their individual income accounts. The same amounts would appear on the sources side, as imputations for receipts in the form of services. Payments to the group would be deducted, as not directly measuring consumption, and payments received from the group would be added to the sources side of the individual income calculation.

The difficulty is in measuring the value of services provided by the collective unit. This problem is solved for such a voluntary collective as a social club by disallowing any deductions for payments made to it by members. In effect, these payments are regarded as measuring the consumption received by members. When it comes to a larger collective organization, such as a State government, this approach is much less satisfactory. The payments to the organization are no longer good proxies for the value of services received. For that reason there is a strong equity case for allowing a deduction of such payments in calculating individual income (including, in individual income, any grants received -- "negative taxes").

Unfortunately, there is no practical method for imputing to individuals the value of services received, so that it is not possible to carry out the complete income measurement system. As in the case of services from owner-occupied homes, the model plan concedes that the value of most services provided collectively will be excluded from the tax base. And as with owner-occupied housing, there is a resulting bias introduced by the Federal tax system in favor of State and local collection expenditure over individual expenditures. The general principle, then, is that payments to the State or local government are excluded from the tax base other than in cases when there is a reasonable correspondence between payments and value of services received. There remains, however, the question of what constitutes "payment" for this purpose, and here particular difficulty is presented by indirect taxes such as sales taxes. Analysis of this issue, together with considerations of simplicity in administration, lead to the prescription of the model tax system that <u>a deduction is allowed only for State and local income taxes. Other taxes may be deducted only as costs of doing business</u>.

<u>Income Tax Deductibility</u>

Income taxes represent the clearest analogy with dues paid into a voluntary collective. These payments reduce the resources available to the payor for consumption or accumulation, and hence they are properly deductible.

<u>Property Tax Deductibility</u>

The issue of property tax deductibility for homeowners has been discussed above. Deduction of that tax should not be allowed so long as the associated implicit rental income from housing is excluded from taxable income. Other State and local taxes that are generally deductible under present law are income taxes, general sales taxes, and motor fuel taxes.

<u>Sales Tax Deductibility</u>

General sales taxes, it may be argued, should not be deducted separately because they do not enter household receipts. Unlike the personal income tax, which is paid by households out of gross-of-tax wages, interest, dividends, and the like, the sales tax is collected and remitted to government by businesses that then pay employees and suppliers of capital out of after-sales-tax receipts. Therefore, the sum of all incomes reported by households must be net of the tax; the tax has already been "deducted" from income sources. To allow a deduction to individuals for the sales tax would be to allow the full amount of the tax to be deducted twice.

The argument above is modified somewhat to the extent that the rate of sales tax varies among States and localities that trade with each other. Jurisdictions with high sales tax rates may sustain locally higher prices if they can effectively charge the sales tax to their own residents who purchase goods outside the jurisdiction. In this case, compensating higher wages, rents, etc. (in money terms) must also prevail in the high-rate area to forestall outmigration of labor and capital. The additional tax will increase nominal income receipts in the region of high tax rates.

The question is an empirical one on the degree to which sales taxes do result in price level differences among jurisdictions. In view of the difficulty of establishing this relationship and of measuring the individual expenditures on which sales taxes are paid, the deduction for sales taxes is not allowed in the model comprehensive income tax. A disadvantage of this treatment is that to the extent sales taxes do cause price level differences, the choice of financing investment by State and local governments will be biased toward income and away from sales taxes.

Alternative Treatments of Sales and Income Taxes

An alternative treatment of both sales and income taxes may be considered, whereby a deduction is allowed only for amounts in excess of a significant floor (possibly expressed as a fraction of the tax base). As at present, standard amounts of sales tax, related to income, could be included in the income tax form, with sales taxes on large outlays (e.g., for an automobile) could be allowed in addition to making the calculation. This approach would relieve most taxpayers of recordkeeping and be roughly equivalent to including at least some of consumption services that are provided by State and local governments in the tax base. (The floor could even be related to an estimate of the extent to which State and local taxes finance transfer payments, included in the base by recipients.)

Benefit Taxes

Certain State and local government services are financed by taxes and charges that are closely related to the taxpayer's own use of those services. Such taxes can be looked upon as measures of the value of consumption of those services and so should not be excluded from income. This argument holds especially for State and local taxes on motor fuels that are earmarked for the construction of highways and for other transportation services. The amount of gasoline consumed is a rough measure of the value of these services used, and, conversely, the consumer can choose the amount of highway services used, and taxes paid, by choosing the size of vehicle and the amount of his driving.

Other State and local user charges and special taxes, such as sewer assessments, fishing licenses, and pollution taxes, are not deductible under current law. This treatment is consistent with the arguments above. In addition, there are a number of local excise taxes that were enacted at least partly for the purpose of controlling consumption. Allowing deduction of such taxes, e.g., on gambling, alcohol, tobacco, firearms, etc., would be adverse to this purpose.

CONTRIBUTIONS TO CHARITIES

Contributions to qualified charitable organizations are presently deductible, subject to certain limits, as an indirect subsidy to philanthropy. Gifts are arguably also of a different nature than ordinary consumption for the donor, and therefore not part of income. Against this view, the voluntary nature of contributions may be cited as evidence that contributors derive satisfaction from giving just as they do from other uses of resources. Since contributions are not taxed to donees, either when received by philanthropic organizations or when distributed to ultimate beneficiaries, a component of income is clearly lost to the tax base as a result of the present policy. Taxation of the donor may be regarded as a substitute for taxation of the donee.

Accordingly, the model tax would allow no deduction to the donor for gifts to charitable organizations and would not include benefits of such donations in income to recipients.

The question of how to treat charitable contributions extends beyond issues of income measurement, however. Many persons would regard the benefits of a tax incentive to philanthropy as more valuable than the potential benefits of tax simplification and horizontal equity of the model tax treatment. Consequently, optional methods for providing an incentive to charity, in the form of donor deductibility or a tax credit, also are discussed.

Charity as Income to Beneficiaries

A charitable contribution is a transfer between a donor and beneficiaries with a philanthropic organization as an intermediary. The philanthropic organization usually converts cash contributions into goods and services, such as hospital care, education, or opera performances, that are subsidized or provided free to the beneficiaries. In many cases, e.g., cancer research, the benefits are very broadly diffused throughout society. The value of these services is a form of income-in-kind to the beneficiaries, but under present law there is no attempt to tax beneficiaries on that income.

The logic of the tax treatment of charitable contributions is much the same as that for gifts or bequests to individuals. A gift does not add to the standard of living of the donor, although it does for the beneficiary. If the taxpayer's standard of living is the appropriate criterion for taxability, proper treatment would be to allow deduction of the gift as at present, but with taxation to the recipient, subject only to the general exemption of very low-income taxpayers.

There is, however, no generally satisfactory way to measure or allocate the benefit-in-kind resulting from charitable donations. While total benefits might be measured by their cost, a large input to benefits-in-kind is voluntary effort that is very difficult to value.

Charities as Public Goods

Even if it were practical to tax benefits-in-kind, it still could be argued that the benefits should not be taxed because they flow to society generally as well as to the individual recipient. Many philanthropic activities provide services, e.g., basic research, education, etc., that benefit the public at large. Deductibility of contributions to such activities provides an incentive for this provision without direct government control.

On the other hand, some persons argue that this kind of hidden public finance should not be given to programs that are under private, and perhaps even individual, control. Moreover, it may be viewed as inequitable that some beneficiaries should receive untaxed benefits if others must pay the full cost for similar benefits (e.g., education, health care, etc.).

A Practical Alternative to Taxing Charitable Organizations

If it is considered logical but impractical to tax benefits to the beneficiary, an alternative approximation is to tax the donor by denial of deductibility. The charitable contribution is easily measurable and taxable in a practical sense. If the donor reduces his contributions by the amount of the additional tax he pays, the donor indirectly shifts the tax burden to beneficiaries. Denial of deductibility, therefore, may be viewed as a proxy for taxing beneficiaries. This describes the present treatment of gifts between individuals. The model tax repeats this treatment for gifts to organizations.

Alternative Tax Incentives for Philanthropy

The rationale for deductibility of gifts and exemption from income of charitable institutions comes down to providing a tax incentive to encourage their activities. On the other hand, concern for tax equity only would suggest taxation of the full value of the charitable contribution on at least one side of the transfer. The latter conclusion may be reached whether one invokes a "standard-of-living" or an "ability-to-pay" criterion of equity.

Optional Tax Credit. The use of the tax system to provide an incentive for charitable activities may be accomplished by an alternative policy option -- the replacement of the deduction with a tax credit. A flat credit (percentage of contribution) could be provided at a level that would just balance the revenue gain from denying deductibility. A credit of, for example, 25 percent would provide additional tax savings to those with marginal tax rates below 25 percent and impose more taxes on those with marginal rates in excess of 25 percent. In addition to this redistributive effect, this alternative tax incentive may result in certain activities, such as education, health care, and the arts, bearing the additional burden nominally imposed on the higher-income contributors. Other activities, such as religion and welfare, might be more likely to benefit from the tax savings given to lower-income contributors.

The choice between tax credits and deductions thus requires a judgment about the desired amount of stimulus among types of charities. The relative fairness of these devices may be judged according to one's concept of income. If gifts are regarded as reductions in the donor's income, and if rates of tax are chosen to produce a desirable degree of tax progressivity, then the deduction is to be preferred on equity grounds. Conversely, if charitable giving is a use of one's income that is to be encouraged by public subsidy, a subsidy per dollar of gift that does not vary with the taxable income of the donee may be more appropriate.

CASUALTY LOSSES

Model Tax Treatment

The issue of deductibility of casualty losses is analogous to that of the property tax deduction. Damage to property due to accidents or natural disasters reduces the present and potential income from ownership of that property. Consequently, casualty losses are properly deductible business expenses. However, as argued previously, owner-occupied houses and consumer durables produce incomes equal to a certain portion of the current rental value to the user, and that income is fully exempt from tax under present law and would be under the model tax. Deduction of casualty losses would represent an asymmetric treatment of these household assets -- their income is exempt from tax, but interruption of the flow of income due to casualty would provide a tax reduction. The model tax would allow no deduction for casualty losses except to business property. Casualty insurance premiums for household property would not be deductible and insurance benefits would not be included in income.

Present Law Treatment

Under current law, insurance premiums are not deductible, but proceeds offset the deduction for actual losses. Hence, the effect for insured losses is the same as full deduction of losses, without floor, and inclusion of insurance proceeds in income.

The logic cited above for refusing the deduction of losses would suggest that insurance premiums for household assets also are a cost of maintaining tax-exempt income. Such costs, therefore, should not be deductible. Because insurance premiums are approximately equal to the expected value of insurance benefits, if no deduction is allowed for premiums, the aggregate of insurance benefits may be regarded as tax-prepaid. Consequently, these benefits should not be taxable as income when paid.

INTERNATIONAL CONSIDERATIONS

The Residence Principle

There are two basic prototype approaches to the taxation of international flows of income. The first is the residence principle, under which all income, wherever earned, would be defined and taxed according to the laws of the taxpayer's own country of residence. The second prototype is the source principle, which would require the taxpayer to pay tax according to the laws of the country or countries in which his income is earned, regardless of his residence. Adoption of one prototype or the other, as compared with the mixed system that now prevails, would have the desirable effect of insuring that no part of an individual's income would be taxed by more than one country, and would reduce the number of bilateral treaties necessary to assure against double taxation.

A number of considerations point to the residence principle as the more desirable principle to establish. First, the concept of income as consumption plus change in net worth implies that attribution of income by source is inappropriate. Income, by this definition, is an attribute of individuals, not of places. Second, if owners of factor services are much less mobile internationally than the factor services they supply, variations among countries in taxes imposed by residence will have smaller allocation effects than tax variations among places of factor employment. Third, the income redistribution objective manifested by the use of progressive income taxes implies that a country should impose taxes on the entire income of residents. The usual concept of income distribution cannot be defined on the basis of income source.

For these reasons, the model plan recommends that the United States seek, as a long-run objective, a world wide system of residence principle taxation. This objective would be made much more feasible with the integration of individual and corporate income taxes. Clearly, the residence principle requires that a taxable income be attributable to persons. If taxable income were attributed to corporations, they would be encouraged to move their residence to countries with low tax rates.

Even after establishment of the residence principle, some problems would remain. For example, individuals who live in countries that tax pensions upon realization might be induced to retire to those countries that require prepayment of taxes on pensions by including pension contributions in taxable income. Such international differences in tax structure would contine to require bilateral treaty agreements.

Establishing the Residence Principle

To encourage the establishment worldwide of the residence principle, the model tax would reduce in stages, and according to the outcome of international treaty negotiations, the rates of U.S. withholding taxes on income paid to foreign residents and the foreign tax credit allowed to U.S. residents on foreign source income. This process would depend upon corresponding reductions by foreign countries in the taxation of income of U.S. residents.

The first step in the process of establishing the residence principle is to define a unique tax residence for each individual. These definitions would be established initially by national statute, and ultimately settled by international tax treaty. The second step would be to devise a tax system that encouraged other countries to forego taxation of U.S. residents on income earned abroad. This fundamental change in tax jurisdiction will take time, and it is important that international flows of labor, capital, and technology not be hampered by double taxation during the transition period. Accordingly, transition to the model U.S. tax system would be designed as a slow but steady movement toward residence principle taxation.

Interim Rules

Foreign Shareholders. As a practical matter, it would not be feasible to exempt foreign shareholders from U.S. taxation until such time as the residence principle received broad political acceptance both in the United States and abroad. Initially, therefore, foreign shareholders might be subject to a withholding tax of perhaps 30 percent on their share of corporate income (whether or not distributed), with the rate of taxation subject to reduction by treaty. Other forms of income paid to foreign residents would continue to be subject to withholding tax at existing statutory or treaty rates. These rates also could be reduced by treaty.

Foreign Tax Credits. Eventually, a deduction -- not a credit -- should be allowed for foreign income taxe, because they are not significantly different from State and local income taxes, for which a deduction is also allowed. This approach would encourage foreign governments to provide U.S. firms operating abroad with benefits approximately equal to the amount of taxes. Otherwise, U.S. firms would gradually withdraw their investments. However, it will take time for foreign governments to accept the residence principle, just as the United States is not immediately willing to forego withholding taxes on U.S. source income paid to foreign residents. In the meantime, for reasons of international comity, and in order not to interrupt international flows of factor services, the United States would continue to allow a foreign tax credit to the extent of its own withholding tax on foreign income. In the case of corporate-source income, the initial credit limitation rate would be 30 percent (and the remainder of foreign taxes would be allowed as a deduction). In the case of other income, the credit limitation would be determined by the U.S. statutory or treaty withholding rate on the particular type of income.

Foreign Corporations. In keeping with the model income tax definition of income, the earnings of a foreign corporation controlled by U.S. interests would flow through to the domestic parent company and then to the shareholders of the domestic parent. The U.S. parent corporation would be deemed to receive the before-foreign-tax income of the subsidiary even if no dividends were paid. This would eliminate deferral here just as the integration plan eliminates shareholder deferral of tax as income in the form of corporate retained earnings. A foreign tax credit would be allowed for the foreign country's corporate income tax and withholding tax to the extent of the 30-percent limit. Excess foreign taxes would be deductible.

The earnings of foreign corporations that are not controlled by U.S. interests would be taxable in the hands of U.S. shareholders only when distributed as dividends, and, therefore, a deduction rather than a credit would be allowed for any underlying foreign corporate income tax. A foreign tax credit would be allowed to U.S. shareholders only to the extent of foreign withholding taxes, and limited by the U.S. withholding rate on dividends paid to foreign residents. (The remainder of foreign withholding taxes would be allowed as a deduction.)

Other Foreign Income. Other types of foreign income paid to U.S. residents would be similarly eligible for a foreign tax credit, again limited by the U.S. tax imposed on comparable types of income paid to foreigners. Thus, a U.S. resident earning salary income abroad would be allowed to claim a foreign tax credit up to the limit of U.S. withholding taxes that are imposed on the salary incomes of foreign residents in the U.S.

THE FILING UNIT

To this point, the concern of this chapter has been to develop a practical definition of income for purposes of a comprehensive income tax. That discussion has involved issues of timing, valuation, and scope, as well as considerations of administrability. The major issues that remain to be discussed have to do with assessment of the tax against income as defined.

Model Tax Treatment

Among the more difficult problems of translating an income definition into a tax system are (1) to determine what social or economic unit should be required (or allowed) to file a tax return and (2) how rates are to be applied to filing units having different characteristics. The model tax would designate the family as the primary tax unit, with separate rate schedules, as under current law, for three types of families -- unmarried individuals without dependents, unmarried individuals with dependents (heads of households), and married couples with or without dependents. Other provisions for two-earner families and for dependent care are described below.

Problems of Taxation of the Filing Unit

To illustrate the issues involved in choosing among alternative tax treatments of families, consider the following potential criteria:

1. Families of equal size with equal incomes should pay equal taxes.

2. The total tax liability of two individuals should not change when they marry.

Both of these appear to be reasonable standards. Yet, there is no progressive tax system that will satisfy them simultaneously. This is readily illustrated by the following hypothetical case. Both partners of married couple A work, and each has earnings of $15,000. Married couple B has $20,000 of earnings from the labor of one partner and $10,000 from the other.

If individual filing were mandatory, with the same rate structure for all, couple A may pay less tax than couple B. This is a consequence of applying progressive rates separately to the earnings of each partner. Suppose marginal rates were 10 percent on the first $15,000 of income and 20 percent on any additional income. In this example, couple A would owe $1,500 on each partner's income, or a total of $3,000. Couple B would owe $2,500 on the larger income and $1,000 on the smaller, or a total of $3,500. This violates the first criterion.

Now consider a system of family filing in which all income within the family is aggregated and the tax is calculated without regard to the relative earnings of each partner. (Unmarried individuals would be subject to the same rates as a family.) In this case, the two couples would pay the same tax on their total income of $30,000. However, both couples would be financially worse off than if they were unmarried. Each couple would now pay a tax of $3,500 on the total of $30,000. As compared with separate filing, more income is taxed at the higher marginal rate. This violation of the second criterion is sometimes referred to as a "marriage tax."

The simplest device for dealing with this penalty on marriage is "income splitting," whereby the combined income of a married couple is taxed as though it were attributed half to one spouse, and half by the other. Each half is subject to the rate schedule applicable to an unmarried individual. To continue the above example, each couple with a total income of $30,000 would, with income splitting, pay a rate of 10 percent on each $15,000 share, or a total of $3,000 in tax. Notice that there may be a "marriage benefit" so long as each prospective spouse does not have the same income. Upon marriage, the combined tax for couple B would fall from $3,500 to $3,000.

Choice of the Filing Unit

Direct appeal to the concept of income does not settle these issues, because that concept presupposes the definition of an accounting unit. There are legal, administrative, and even sociological factors involved in the choice. The major arguments in favor of mandatory *individual* filing can be summarized as follows: (1) no marriage tax; (2) no discrimination against secondary workers; and (3) the administrative ease of identifying individuals without the requirement of a definition of families. By contrast, the arguments in favor of *family* filing are: (1) families with equal incomes should pay equal taxes; (2) families typically make joint decisions about the use of their resources and supply of their labor services; and (3) family filing makes it unnecessary to allocate property rights, as in the case of community property laws, and to trace intrafamily gifts.

The last point is critical. A concept of income as a use of resources implies that each individual's ability to pay includes consumption and net worth changes financed by transfers from other family members. Carried to extreme, this separate treatment of family members would suggest assessment of tax even to minor children. Chiefly because of this problem, <u>it is recommended that the family be made the primary tax unit</u>.

The definition of a family is, of necessity, somewhat arbitrary, as is the application of progressive rate schedules to families of different types. The following definition of a family is adopted here 6/: The family unit consists of husband and wife and their children. The children are included until the earliest date on which one of the following events occurs:

- They reach 18 years of age and they are not then attending school; or
- They receive their baccalaureate degree or;
- They attain age 26; or
- They marry.

Single persons are taxed separately. Persons not currently married and their children living with them are treated as family units.

<u>The Problem of Secondary Workers</u>

A system of joint family filing may cause an efficiency loss to the economy; namely, the discouragement of labor force participation by secondary workers in a family. If a partner not in the labor force is thinking of entering it, the tax rate that person faces is the marginal rate applying to the prospective total family income. This rate may be much higher than that for a single wage earner. This consequence of family filing is sometimes referred to as the "wife tax."

Two-earner families and single-adult families with dependents also face expenses for dependent care, which may be regarded as altering such families' ability to pay taxes. Hence, taxability of families will vary according to the number of adults, the number of wage earners, and the number of children.

Compare the circumstances of three three-person families of equal income: family X has two adult wage earners; family Y has two adults, only one of whom is a wage earner; and family Z has only one adult, who is a wage earner. Family Y alone receives the full-time household and child care services of one adult member and may be regarded as better off on this account. Family X alone bears the wife tax associated with secondary wage earners. Family Z has the additional child care responsibility but also the smaller subsistence outlays associated with two children in place of an adult and one child. The model tax would recognize the difference of the type illustrated by these three families by two special adjustments to taxable income, and by separate rate schedules -- one for families with one adult and another for those with two adults.

Tax Adjustments for Differences in Family Status

The first adjustment in the model tax is that only 75 percent of the wage income of secondary earners would be included in family income. This lower rate of inclusion would apply only to a limited amount of earnings of the secondary worker. In the model tax this limit would be $10,000. Earnings of the secondary worker means the income of all family wage earners, except that of the member with the largest wage income. This provision would reduce the "wife tax" on families with more than one wage earner.

The second adjustment would be a child care deduction equal to half of actual child care costs up to a limit of either $5,000 or the taxable earnings of the secondary worker, whichever is smaller. This deduction would be allowed only for a spouse who is a secondary worker, or for an unmarried head of household. The dependent care adjustment would provide some allowance for the reduced standard of living associated with the absence of full-time household services of a parent.

The model tax would provide separate rate schedules, as in present law, for single individuals, for families with a married couple, and for families with a single head of household. Rate schedules applicable to individuals would be set so that a two-adult family would pay slightly higher tax than two unmarried individuals whose equal taxable incomes sum to the same taxable income as the family. A single individual would, of course, owe more tax than a family with the same amount of taxable income. The schedule of rates for a family with a single head of household would be designed so that the tax liability would be the sum of (1) half the tax calculated from the single rate schedule and (2) half the tax from the rate schedule for couples.

The model tax also would have, as part of its rate schedule, a "zero rate bracket" that would exempt a fixed amount of income on each return from tax. The level of this exemption could be adjusted to reduce the potential marriage benefit that may result from different schedules of positive rates for married as compared to single filers. The desired relation in level and progressivity of tax among taxpayers of different family status would be achieved, therefore, by a combination of rates and rate brackets that is different for each type of family, and also by specifying a level of exemption per filing unit.

Provision of an exemption for each filing unit would have much the same effect as the standard deduction under present law. The exemption would provide a minimum level of income for each family or individual that would not be subject to tax. However, unlike the present law, the use of the exemption by a family would not disallow any other subtractions from receipts in the determination of taxable income. Under the model tax, deductions for employee business expenses, State and local income taxes, pension contributions, interest payments, etc. would not be reduced by, nor dependent upon, the exemption of a subsistence amount of income.

ADJUSTING FOR FAMILY SIZE

Most observers would agree that the tax treatment of families should vary by family size, as well as by marital status and the number of wage earners. The model tax would adjust for family size by means of a specified exemption per family member, as in present law.

Exemptions Versus Credits

The use of the personal exemption as an adjustment for family size has been much criticized. One line of criticism is that the dollar value of an exemption increases with the family's marginal tax rate, so that it is worth more for rich families than for poor families. This observation has led some people to suggest either a vanishing exemption, which diminishes as income increases, or institution of a tax credit for each family member in place of the exemption. The latter approach has been adopted, in a limited way, in the "personal exemption credit" provision of the 1975 Tax Reduction Act, which has been extended temporarily by the 1976 Tax Reform Act. A tax credit reduces tax liability by the same amount for each additional family member regardless of family income.

The argument for a vanishing exemption or family credit often reflects a misunderstanding of the relationship of these devices to the overall progressivity of the income tax. It is true that trading an exemption for a credit without changing rates will alter the pattern of progressivity, making the tax more progressive for large families, less for small families and single persons. But it is also true that, for any given level of exemption or credit, any degree of progression among families of equal size may be obtained by altering the rate schedule. Therefore, in the context of a basic reform of the tax system that involves revision of the rate structure, there is no reason that the substitution of tax credits for exemptions should result in a more progressive tax.

If the change in the standard of living that accompanies the addition of a family member is akin to a reduction in the family's income, then an exemption would be an appropriate family-size adjustment. If, on the other hand, one views the family-size adjustment as a type of subsistence subsidy for each member of a taxpayer's family, a credit may be more appropriate. The model tax reflects the former view.

The point to be emphasized here is that this choice is often argued in the wrong terms. If tax rates are adjustable, the issue of exemptions versus credits is essentially a question of the proper relative treatment of equal-income families of different sizes at various points of the income distribution. Should the tax reduction on account of additional family members be greater as family income increases? Or is this, per se, inequitable?

SAMPLE COMPREHENSIVE INCOME TAX FORM

In order to summarize the major provisions of the model comprehensive income tax, and to provide a ready reference to its provisions, a listing of the items of information that would be required to compute the tax is provided below. In a few cases -- unincorporated business income, capital gains and losses, and income from rents and royalties -- supplemental schedules would be required to determine amounts to be entered. However, as compared with present law, recordkeeping requirements and tax calculation would be simplified greatly, despite the fact that several presently excluded items of income are added.

For most taxpayers, the only calculations that would be complicated would be the exclusion of a portion of wages of secondary workers and the child care allowance for working mothers and heads of households. The rest of the calculation would simply involve the addition of receipts, subtraction of deductions and exemptions, and reference to a table of rates. For single individuals and couples with one wage earner who have only employee compensation and limited amounts of interest and dividends, a still simpler form could be devised.

Sample Tax Form for the Comprehensive Income Tax

Filing Status

1. Check applicable status

   a. Single individual

   b. Married filing joint return

   c. Unmarried head of household

   d. Married filing separately

Family Size

2. Enter one on each applicable line

   a. Yourself

   b. Spouse

3. Number of dependent children

4. Total family size (add lines 2a, 2b, and 3)

Household Receipts

5a. Wages, salaries, and tips of primary wage earner (attach forms W-2)7/

b. Wages, salaries, and tips of all other wage earners (attach forms W-2)

c. Multiply line 5b by .25; if greater than $2,500, enter $2,500

d. Included wages of second worker, subtract line 5c from line 5b

e. Wages subject to tax, add lines 5a and 5d

6. Receipts of pensions, annuities, disability compensation, unemployment compensation, workmen's compensation, and sick pay. (Includes social security benefits, except Medicare, and veteran's disability and survivor benefits.)

7. Interest received (attach forms 1099)

8. Rents, royalties, estate and trust income, and allocated earnings from life insurance reserves (attach schedule E)

9. Unincorporated business income (attach schedule C)

10. Net gain or loss from the sale, exchange, or distribution of capital assets (attach schedule D)

11. Allocated share of corporate earnings (attach forms W-x)

12. Public assistance benefits, food stamp subsidy, fellowships, scholarships, and stipends (attach forms W-y)

13. Alimony received

14. Total receipts (add lines 5e and 6-13)

Deductions

15. Employee business expense (includes qualified travel, union and professional association dues, tools, materials, and education expenses)

16. Nonbusiness interest expense (attach statement)

17. State and local income tax

18. Alimony paid

19. Child care expenses

    a. If line 1c is checked and line 3 is not zero, or if line 1b is checked and both lines 3 and 5b are not zero, enter total child care expenses

    b. Multiply line 19a by .5

    c. Enter smaller of line 19b or $5,000

    d. Child care deduction. If unmarried head of household, enter smaller of line 19c or line 5a

    e. If married filing joint return, enter smaller of line 19c or line 5d

20. Total deductions (add lines 15-18, and 19d or 19e)

Tax Calculation

21. Income subject to tax. Subtract line 20 from line 14 (if less than zero, enter zero)

22. Basic exemption. Enter $1,600

23. Family size allowance. Multiply line 4 by $1,000

24. Total exemption. Add lines 22 and 23

25. Taxable income. Subtract line 24 from line 21

26. Tax liability (from appropriate table)

27. a. Total Federal income tax withheld

    b. Estimated tax payments

    c. Total tax prepayments (add lines 27a and 27b)

28. If line 26 is greater than line 27c, enter BALANCE DUE

29. If line 27c is greater than line 26, enter REFUND DUE

FOOTNOTES

1/ The use of food stamps is restricted to a class of consumption items, but the range of choice allowed to recipients is sufficiently broad that the difference between the face value and the purchase price of the coupon may be regarded as a cash grant.

2/ This imputed income estimates the return to both equity and debt supplied during construction. To include interest paid in the calculation would count the debt portion twice.

3/ To be increased in increments to 12 months according to the Tax Reform Act of 1976.

4/ To be increased in increments to $3,000 according to the Tax Reform Act of 1976.

5/ A rule of thumb that is commonly suggested is that monthly rental is 1 percent of market value. However, as experience with local property taxes has shown, accurate periodic assessment is technically and politically difficult.

6/ This definition is based upon that of Galvin and Willis, "Reforming the Federal Tax Structure," p. 19.

7/ Wages reported by the employer would exclude employee contributions to pension plans and disability insurance, and would also exclude the employee's share of payroll taxes for social security retirement and disability (OASDI). Wages would include employer contributions to health and life insurance plans, the employee's allocated share of earnings on pension reserves, and the cash value of consumption goods and services provided to the employee below cost.

Chapter 4

A MODEL CASH FLOW TAX

INTRODUCTION

This chapter presents a proposal for a consumption base tax as an alternative to a comprehensive income tax. Called a "cash flow" tax because of the simple accounting system used, this tax is designed to replace the current taxes on the income of households, individuals, trusts, and corporations.

The major difference between the cash flow tax and the comprehensive income tax outlined in chapter 3 is that the change in an individual's net worth is effectively excluded from the base of the cash flow tax. In many other respects, the two taxes are alike. Consumption is included in both tax bases. The measure of consumption in the cash flow proposal is broadly similar to that in the comprehensive income tax proposal; it differs mainly in that it includes the flow of consumption from consumer durables and owner-occupied housing and certain other forms of in-kind consumption. The treatment of the family unit for tax purposes is the same in both the comprehensive income and cash flow proposals.

The concern of this chapter is to define the appropriate base of the cash flow tax system. The issue of the progressivity of the tax system is a separate problem that would have to be resolved for either the cash flow tax or the comprehensive income tax. This issue is considered for both taxes in chapter 5.

Cash Flow Accounting

The central feature of the model tax system is the use of cash flow accounting for financial transactions to obtain a measure of annual consumption for any individual or household. The principle involved is very simple. A household could use monetary receipts in a year for three purposes: personal consumption, saving, and gifts. By including all monetary receipts in the tax base, including the entire proceeds of sales of assets and gifts received, and allowing deductions for purchases of assets and gifts given, the annual consumption of a household could be measured without directly monitoring the purchases of goods and services.

The use of cash flow accounting of financial asset transactions to compute the tax base is illustrated, for an average wage earner, in the following example. Suppose a worker earns $10,000 per year in wages, of which he uses $9,000 for personal consumption and $1,000 for saving. Under the cash flow tax outlined in this proposal, the worker could deduct $1,000 from his $10,000 of wages, if he had deposited the $1,000 in a qualified account.

Use of Qualified Accounts. Qualified accounts would be established by banks and other financial institutions, which would keep records of deposits and withdrawals. The worker's $1,000 deposit in the account could be used to purchase any type of financial asset -- savings bank deposits, corporate shares, bonds, mutual funds, or any other claim to current or future income. The future balance in the qualified account would depend, of course, on the profitability of his investments. No tax would be assessed against interest, dividends, or capital gains as they are earned, but the taxpayer would be required to include in his tax base the full value of any withdrawals from his qualified account that were not reinvested in similar accounts. The use of qualified accounts to handle financial transactions would ease the taxpayer's recordkeeping burden and would enable tax authorities to trace the annual flow of funds available for consumption uses.

The qualified accounts described here are very similar to qualified retirement accounts under current law. These accounts include Keogh plans and Individual Retirement Accounts (IRA's), which provide the taxpayer a current deduction for contributions to funds for retirement and, then, include withdrawals from the fund in the tax base after retirement. There are two major differences between the qualified accounts proposed here and qualified retirement accounts provided for in the current tax code. First, withdrawal of funds from the qualified account would be allowed without penalty at any time during a taxpayer's lifetime. Second, there would be no statutory limit to the amount a taxpayer could contribute to a qualified account.

Thus, in the example above, if the worker deposited $1,000 in a savings account, his tax would be computed on an annual cash flow base of $9,000. If, in the following year, he consumed his entire salary of $10,000 and in addition withdrew $500 from his savings account to purchase a color television set, his cash flow tax base in that year would be $10,500. His tax base is geared to the use of his receipts for consumption, currently or in the future.

Alternative Treatment of Investments. An alternative way of handling investments that would enable an individual to alter the timing but not the expected present value of his cash flow tax base would be to include the purchases of assets in the tax base, but to exempt all returns from assets from tax. To continue the example above, the worker could deposit $1,000 of his $10,000 of annual wages in a savings bank, but without using a qualified account. If he did so, the entire $10,000 of wage receipts would be included in his tax base in the initial year, but any future interest earned on the savings deposit and any withdrawal of the principal would be excluded from the tax base. As will be discussed more fully below, the expected present value of the worker's lifetime tax base would be the same for either method of accounting, if he consumes the proceeds of his account during his lifetime.

Investments handled in this alternative way would be treated very simply for tax purposes. The amount invested would be included in the tax base -- the same as consumption -- but all subsequent returns on the investment would be untaxed. In effect, the tax that would otherwise be due on consumption from the proceeds of the investment would be prepaid at the time the investment is made. Allowing taxpayers the choice of this alternative way of handling investment accounts has some advantages, but could create problems, which are discussed below.

The possibility is discussed of dealing with these problems by introducing restrictions on the types of investments that may or must be made through qualified accounts. Although few restrictions are recommended in the model plan, it should be stressed that to increase their number or stringency would be fully consistent with the basic concept of the cash flow tax and would not alter its most important features.

The remainder of this chapter presents the details of a model cash flow tax base and discusses its most important characteristics. The next section points out the tax issues that have common solutions in the model comprehensive income tax and the model cash flow tax. Then, a section is devoted to the major differences between the two tax bases, including a full description of the cash flow tax treatment of investment assets and consumer durables. Another section discusses the economic consequences of adopting a cash flow tax, and the final section presents a sample tax calculation form.

ELEMENTS IN COMMON WITH THE COMPREHENSIVE INCOME TAX

Several of the issues discussed in the preceding chapter would be resolved similarly for a cash flow tax. These questions include the measurement of consumption -- to be taxed alike in both models -- and the related issue of the appropriate treatment of families of varying size and circumstances.

Family Size and Family Status

Under this proposal, the family would be taxed as a unit for reasons analogous to those argued in chapter 3. In order to assess tax to each family member as an individual, it would be necessary to allocate consumption among family members. This would destroy much of the administrative simplicity of the cash flow tax, which rests upon deducting from receipts certain cash outlays that are usually made on behalf of the family as a unit. Receipts are also usually combined at the family level. The argument that standard of living varies by family size holds for a consumption measure of living standard as well as for an income standard. The adjustment device in the model cash flow tax plan discussed in this chapter -- one exemption per family member -- is the same as that proposed for the comprehensive income tax. However, differences in the size of the tax base under the two taxes might require that the exemption levels be different for model taxes intended to raise the same revenue. As in the case of the comprehensive income tax, other approaches to the adjustment for family size would be fully consistent with the cash flow tax base.

Adjustments that account for differences among families in the number of wage earners and the availability of a full-time adult in the household apply to labor-related earnings and expenses only. They would be just as appropriate, therefore, under a consumption tax as under an income tax. The structure of rates required to achieve the desired pattern of progressivity might be different, however.

Deductions for Charitable Contributions, Medical Expenses, and Taxes

Contributions to Charities. As in the case of the comprehensive income tax base, deductions for charitable contributions would not be allowed under the model cash flow tax. Conceptually, under a cash flow tax, itemized gifts should be deductible by the donor and included in the receipts of the donee. Following the discussion in chapter 3, including receipts from charities in the tax base of the recipient is rejected as impractical. Charity is not usually given in cash or in goods that are easy to value, and sometimes the benefit is to society generally, so that beneficiaries cannot be separately identified. Nor should the charitable institutions be taxed. They do not consume; they merely act as intermediaries to distribute the benefits to the ultimate recipients. The foregoing suggests that the best way to tax consumption resulting from charitable activities would be to count charitable contributions as consumption by the donor and not to allow a tax deduction.

In opposition to this proposal, it may be argued that tax-free consumption of goods and services provided by charities should be maintained because these goods and services provide a public service function. Proponents of this view would argue for either a deduction or some form of tax credit for charitable contributions. As noted in chapter 3, however, the decision whether or not to allow the deduction of charitable contributions is not essential to the basic integrity of the overall proposal.

There is one element of the comprehensive income tax discussion of charities that does not apply to a cash flow tax. The undistributed portion of endowment earnings of charitable organizations should not be taxed even if taxation of organizations on the basis of contributions is viewed as feasible and recommended as a general policy.

Medical Expenses. The issues involving medical expenses and medical insurance are exactly the same for the cash flow tax as for the income tax. Consequently, the same policy options are prescribed for both model taxes.

State and Local Income Taxes. The model cash flow tax treatment of State and local taxes also would be the same as that under the model accretion tax: income taxes would be fully deductible because they are not regarded as part of consumption. Other taxes would not be deductible, except as business expenses.

Property Taxes. No property tax deduction would be allowed to homeowners under either of the model taxes. The rationale for denying deduction of the property tax for owner-occupied homes is, however, somewhat different in the case of the cash flow tax. The cash flow tax would measure the owner's consumption of housing services as the purchase price (or capital value) of the dwelling. In a market equilibrium, this price is the present value of the prospective stream of imputed rents less current costs. These costs include property taxes. Therefore, a higher local property tax, if uncompensated by services to the property, would result in a lower market price of the dwelling. In this way, the property tax is excluded from the base of the cash flow tax without an explicit deduction.

Health, Disability, and Unemployment Insurance

Those types of insurance that are purchased for a 1-year term and pay benefits directly to the insured -- health, disability, and unemployment insurance -- are no different in concept or model tax treatment under the cash flow tax than under the accretion tax. They are included in the definition of consumption. The differences in treatment among them -- taxation of benefits in the case of disability and unemployment, and of premiums for health insurance -- are explained in the preceding chapter. The model tax treatment is the same for each of these items whether the insurance is public or private, employer-paid or employee-paid. However, life, casualty, and old-age insurance do present differences in concept under the consumption tax and will be discussed below.

Casualty Losses

Casualty losses would not be deductible under the model comprehensive income tax or under the cash flow tax. Again, however, the rationale for not allowing the deduction under the cash flow tax is slightly different. Under the cash flow tax, changes in net worth would not be included in the tax base, and, therefore, reductions in net worth, in general, should not be deducted. Further, as explained below, all taxation for the consumption of consumer durables would be prepaid at the time of purchase, and subsequent sales of consumer durables, at whatever price, would not be included in the tax base. Following the same reasoning, the premiums for casualty insurance would not be deductible under the cash flow tax proposal, and the proceeds would be excluded from the tax base.

DIFFERENCES BETWEEN THE CASH FLOW TAX AND THE COMPREHENSIVE INCOME TAX

The major difference between the cash flow tax outlined here and the comprehensive income tax presented in chapter 3 follows directly from the definition of the two bases. Under the cash flow system, changes in net worth would not be included in the tax base, but the comprehensive income tax would attempt to include all changes in net worth to the extent administratively feasible. Thus, the cash flow tax and the income tax differ in their treatment of purchases of assets and returns from asset ownership. Specifically, the two taxes differ most in the handling of corporate profits, income from unincorporated business, capital gains, interest received on savings and interest paid on loans, rental income, income accrued in retirement plans and life insurance, and casualty losses.

The first part of this section discusses in some detail the treatment of investment assets and consumer durables under the cash flow tax proposal. In the second part, a comparison is made between specific provisions of the model comprehensive income tax and the handling of corresponding items under the model cash flow tax.

The Treatment of Assets Under a Cash Flow Tax

The cash flow tax would greatly simplify tax accounting and tax administration regarding real and financial assets. Accounts to determine capital gains, depreciation, and inventories -- among the most complex necessitated by the current tax code -- would no longer be required. For many individuals, no accounting would be necessary for asset purchases nor for receipts associated with asset ownership. For other taxpayers, simple annual cash flow data would provide all the necessary information for computing tax liability. The taxpayer would merely record the net annual deposits or withdrawals from qualified accounts. Accounting for the cash flow tax would rest solely on marketplace transactions for the current year, thus minimizing the need for long-term recordkeeping.

Family-Owned Businesses. The simplicity of cash flow tax accounting is best illustrated by the model tax treatment of a family-owned business. All cash in-flows would be counted as receipts. Cash outlays that represent business expenses -- including all purchases of equipment, structures, and inventories -- would be deducted from receipts; that is, instantaneous depreciation for tax purposes would be allowed on all investments regardless of the durability of the asset purchased. The difference between receipts and cash outlays would be included in the individual's tax base. If cash outlays exceed business receipts in any year, the difference would reduce receipts from other sources.

For example, suppose a family derived all its receipts from a family-owned grocery store. To compute its tax base, the family would add up all cash receipts from sales and subtract from this amount all business outlays, including payments to employees and cash outlays for electricity, rent payments for the store, purchases of machinery, and purchases of inventories. These would be the only calculations the family would make to determine its tax base under the cash flow tax. No data on capital gains or depreciation would be required to determine taxable receipts.

Financial Assets. Financial assets, including stocks, bonds, and savings deposits, owned by taxpayers via qualified accounts would be recorded for tax purposes in the same way as annual purchases and sales associated with a family-owned business. All deposits for purchases of assets would be deducted from other receipts in computing the tax base. All withdrawals, whether arising from dividends, interest, or asset sales, would be included in the tax base. No distinction would have to be made between the gain from sale of an asset and the return of capital invested.

For example, suppose an individual deposits $100 in a qualified savings bank account, where it earns 10 percent annual interest. In the year he makes the $100 deposit, he would be allowed to deduct $100 from current receipts in computing his tax base. If, in the following year, he withdraws the principal plus earned interest -- now equal to $110 -- the amount withdrawn would be added to receipts from other sources in computing the tax base. If, instead, the savings deposit were left in the bank to accumulate interest, there would be no current tax consequences. Any future withdrawal would add to taxable receipts in the year it is made.

Deductions for the purchase of assets would be allowed only if the purchase were made through a qualified account. This device would offer a simple way to insure compliance with the cash flow tax. Individuals would be permitted to keep qualified accounts with savings banks, corporations, stockbrokers, and many other types of financial institutions. The net amount of deposits in, and withdrawals from, qualified accounts during the year would be reported by the institution to both the taxpayer and tax authorities. The present dividend-reporting requirements for corporations may be viewed as a model for the way financial institutions would report net withdrawals and deposits from qualified accounts for the cash flow tax.

The tax base of an individual would include the sum of net withdrawals from all qualified accounts. If deposits exceeded withdrawals, the excess would be subtracted from other receipts in computing the tax base. The sale of one asset out of a qualified account and subsequent purchase in the same year of another asset of equal dollar value would have no net tax consequences if the new asset were also purchased in a qualified account.

Consumer Durables. It is technically feasible, but practically unattractive, to apply the cash flow concepts just described to the purchase of consumer durables. Unlike financial assets, consumer durables such as automobiles, houses, and major home appliances, all yield flows of services to the owners that are not measured by annual monetary payments. Thus, to allow a deduction for consumer durable purchases and then to include only future monetary receipts in the tax base would amount to excluding from the tax base the value of consumption services yielded by durable goods. Because it is difficult to determine the annual value of the use of consumer durables the same concepts used for financial assets cannot be easily applied.

For example, suppose an individual purchased an automobile for $4,000 and sold it for $2,000 3 years later. If a deduction were allowed for the purchase and, then, the sale value included in receipts, the individual's total tax liability would be lowered by owning the automobile. However, the individual would have expended $2,000 plus some foregone interest for the consumption services of the automobile over the 3-year period. The depreciation and foregone interest measure the cost of the consumption services and should be included in the tax base. If the automobile were taxed the same way as an asset in a qualified account, this consumption value would escape the tax.

To assure that the entire consumption value is included in the tax base, the appropriate treatment of consumer durables is to allow no deduction on purchase and to exclude sales receipts from the tax base. In other words, purchase of a consumer durable would be treated the same way as current consumption of goods and services. The reason for this approach is that the price paid for a consumer durable should reflect the present value of future services the buyer expects to receive. Including the value of durable goods in the tax base at the time of purchase produces, in effect, a prepayment of the tax on the value of future consumption services.

According to this treatment, the $4,000 for the purchase of the automobile would not be deducted from the tax base. Similarly, the $2,000 from sales of the automobile 3 years later would not be included in the tax base. Thus, if an individual sold a used car and bought another used car for the same price, or used the proceeds for current consumption, there would be no tax consequences. If he sold a used car for $2,000 and invested the proceeds in a qualified asset, he would deduct $2,000 from his tax base in the year of the transaction.

In summary, the purchase of a durable good would be treated as present consumption even though the good yields consumption services over time. The reason for this approach is that the price of the good reflects the expected present value of its future stream of services. Measuring annual service flows directly would require the measurement of annual depreciation and annual imputed rent on the value of the asset. This would introduce unwanted and unnecessary complexity into the cash flow tax system.

<u>Checking Accounts</u>. Deductions should also be derived for purchases of certain types of financial assets that yield their primary benefits in the form of services received, rather than monetary returns. For example, non-interest-bearing demand deposits provide services for depositors in place of interest. Deductions, therefore, should <u>not</u> be allowed for deposits in checking accounts, and withdrawals from checking accounts should <u>not</u> be included in the tax base. That is, checking accounts should not be qualified accounts.

Equivalence of Qualified Account Treatment and Tax Prepayment Approach

The equivalence noted above between the purchase price of a consumer durable good and the present value of its expected future services suggests an analogous equivalence between the price of a business or financial asset and the present value of its expected future stream of returns. This equivalence can best be illustrated by a simple example. Suppose an individual deposits $100 in a savings account at 10 percent interest in year 1. In year 2, he withdraws the $100 deposit plus $10 earned interest and uses it to buy consumption goods.

Qualified Accounts Treatment. If the savings account is a qualified account, the individual would reduce his tax base by $100 in year 1 and raise it by $110 when he withdraws his funds from the account in year 2. At an interest rate of 10 percent, the discounted present value in year 1 of his second-year tax base would be $110/1.10, or $100.

Tax Prepayment Approach. Now, suppose instead that the savings account is not a qualified account. In this case, the individual is not allowed a deduction for the deposit and is not taxed on interest earned or on funds withdrawn in year 2. The discounted present value of his tax base would be the same in this case as under the cash flow rules initially presented. The tax base in year 1 would be $100 higher, and the discounted present value of the tax base in year 2 would be $100 lower, than if a qualified account were used. In other words, allowing a deduction for purchases of assets and taxing withdrawals -- the qualified accounts treatment --is equivalent to allowing no deduction for the asset purchase and exempting all interest earnings from tax -- the "tax prepayment" approach.

The consequences to the government of the two ways of taxing the purchase of assets would also be the same in present value terms. If the individual bought the asset through a qualified account, the Government would collect revenue on a tax base of $110 in year 2. If the interest were exempt from tax, and no deduction for the asset purchase allowed, the government would collect revenue on a tax base of $100 in year 1. This revenue would grow to $110 by year 2 at 10 percent interest. Ignoring possible variations in average tax rates, the government would be left with the same revenue at the end of year 2 in both cases.

The example above suggests that all assets may be treated according to the tax prepayment method for required consumer durables. Asset purchases would not be deducted from the tax base, and all earnings from assets and sales of assets would not be included in the tax base. Thus, for assets not purchased through qualified accounts, it would not be necessary to keep any records for tax purposes. The expected present value of the tax base would be the same for both methods of tax treatment of assets, although the timing of payments would be different. Both methods of tax treatment of assets are consistent with a cash flow approach to taxation.

It is worth repeating that allowing an alternative treatment of financial assets outside of qualified accounts, tax prepayment, is not essential to the integrity of the proposal, but it would provide convenience and some other advantages. In the cash flow proposal presented in this study, purchases of financial assets except for investments in a family business or closely held corporation, would be allowed to have tax-free returns if the investment were not deducted. Alternative rules are possible: (1) to require all asset purchases, except for consumer durables, to be made through qualified accounts; or (2) to continue to tax returns from assets purchased outside of qualified accounts (i.e., dividends, interest, rental income, capital gains) as they would be taxed under either a comprehensive income base (described in chapter 3) or under the current tax law. The current taxation of returns would strongly encourage, but not require, taxpayers to purchase income-earning assets through qualified accounts. Otherwise, the present value of tax liability would ordinarily be higher and recordkeeping and tax accounting more costly.

Treatment of Borrowing and Lending

The equivalence between the amount invested in an asset and the expected present value of returns also permits two alternative ways of treating loan transactions. Normally, under cash flow accounting, receipts from a loan would be handled through qualified accounts. An individual would be required to report the loan proceeds in his tax base in the initial year. (Of course, if he used the loan proceeds to purchase investment assets through a qualified account in the same tax year, there would be no net tax consequence.) Subsequent interest and principal payments would then be deductible from the tax base in the following years. If the individual sold assets that had been purchased through qualified accounts in an amount just sufficient to pay the loan interest and principal, the net tax consequence would, again, be zero. On the other hand, if the loan were taken outside a qualified account, proceeds of the loan would not be included in the tax base, and repayments of interest and principal would not be deductible. Note, again, that the present value of the tax liability would be the same in either case. The discounted value of future interest and principal payments on a loan would be equal to the current proceeds of the loan.

Advantages of Taxpayer Option Treatment of Asset Purchases and Borrowing

There are significant advantages to a flexible cash flow tax that allows a taxpayer to chose, subject to certain limits, whether or not to use qualified accounts to make financial transactions.

Averaging of Consumption. One advantage is the potential for evening out over time large outlays that are made irregularly, such as the purchase of a house or an automobile, or payment for college. According to the rules suggested above, cash outlays for consumer durables would not be deductible, so that borrowing via a qualified account would produce taxable receipts for which there would be no immediate offset. In buying a home, an individual probably would wish to borrow outside a qualified account. Otherwise he would pay tax on the entire mortgage in the year of the purchase. If the loan were not obtained through a qualified account, the proceeds of the loan would not be included in the tax base, but future principal and interest payments would not be deductible. Thus, tax liabilities from consumption of the good financed by such a loan would be spread out over the period of repayment, as the taxpayer used receipts from other sources, such as current wages, to pay the loan interest and principal.

The existence of alternative ways of treating financial assets and loans for tax purposes would give individuals considerable flexibility in the timing of their tax liabilities. This feature of the cash flow tax is desirable because it would minimize the need for special averaging provisions. Averaging is desirable because increasing marginal rates would be applied to increases in the tax base for any single year.

With increasing marginal rates, an individual with a tax base of $10,000 in year 1 and $30,000 in year 2 will pay higher taxes than an individual with a tax base of $20,000 in both years. Whether the tax base is comprehensive income or consumption, it is hard to see why the first individual should be considered to be in a better position to pay taxes than the other.

An example of the optional use of qualified accounts for the purpose of averaging consumption is the following: Suppose an individual purchased a $40,000 house, on which the bank made available a $30,000 mortgage. If the individual chose not to include the loan proceeds from the $30,000 mortgage in his tax base, he could not deduct mortgage payments in future years. In effect, the individual could pay the principal and interest on the mortgage every year out of current receipts from other sources. The receipts used for the annual mortgage payments would be included in the tax base. Thus, the tax base on the mortgage could be made to approximate the schedule of mortgage payments on the house.

This leaves the problem of the down payment. The $10,000 used for the down payment, if withdrawn from a qualified account, would be included in entirety in the tax base in the year the house was purchased. The individual, if he had foreseen buying a house, could have avoided this problem by saving outside the qualified account. The money devoted to acquiring these financial assets would have been included in the tax base every year but, the tax having been prepaid, the lump sum withdrawal would not be subject to tax. These savings could then be transferred to the purchase of equity in housing. The prepayment of taxes would continue to apply to the stream of consumption services from housing, as it did to the yield from financial assets.

In most other cases, individuals would probably want to save in <u>qualified</u> accounts for averaging purposes. Most people save during their most productive years, when income is highest. The savings are used to finance consumption after retirement. By saving in qualified accounts, an individual could reduce his tax liability in the years when his income is high relative to consumption, and raise it in the future when income is low. On the other hand, saving outside of qualified accounts might be an individual's best strategy when he anticipates large consumption expenditures such as a down payment for a house or college expenses. To the extent that the taxpayer remains in the same tax bracket for substantial variations in his tax base, the choice among types of accounts for reasons of averaging would be unnecessary.

Privacy. A second advantage of allowing optional treatment of asset purchases is that taxpayers would not be compelled to make all financial investments through a third-party broker. The existence of assets not monitored by third parties, or by the government, would allow a person to maintain the privacy of his accounts without changing the present value of his tax base.

Equality of Treatment Among Asset Types. A third advantage of allowing optional treatment for financial assets is that it would give investors in such assets the same opportunities available to investors in consumer durables. For both types of investments the initial and subsequent amounts would not be deductible and all returns, including sale of the asset, would not be subject to tax.

Lifetime Perspective of the Cash Flow Tax

At this point, it is worth emphasizing again the life-time perspective of the cash flow tax system. The flex-ibility of asset treatment and the use of individual discretion over any 1 year's tax liability would allow both postponement and advancement of tax liabilities. By allowing individuals to avoid taxes totally in some years by judicious rearrangement of asset purchases, these provisions might appear to provide a tax loophole. However, this loophole is apparent only -- any reduction in tax base must be matched by a future tax base increase of equal present value. There could be no advantage to deferral if interest earnings were positive. Furthermore, because of progressive tax rates, it would be to the advantage of taxpayers to try to average their tax base over time. Thus, taxpayers would have an incentive to pay some tax every year, even though the means to postpone the tax is available.

An Example. To see how an individual could use the system to avoid taxes in a given year, and why it would not be to his advantage, consider this example. Suppose a worker earned $20,000 per year and accumulated wealth equal to $20,000 by saving outside a qualified account. In another year, he deposits the entire $20,000 in a qualified account, deducting the deposit from his wages. He would then report taxable receipts of zero in that year and, thereby, succeed in "sheltering" his consumption. (Less than \$20,000 would need to be switched to a qualified account if there are personal exemptions.) However, this way of managing his financial portfolio probably would increase, rather than decrease, the present value of his tax payments <u>over his lifetime</u>.

This point can be illustrated by showing that taking part of the \$20,000 deduction in either a previous or future year, would yield tax savings. For example, suppose he deposited only \$19,000 in a qualified account in the year in question, deducting the additional \$1,000 by depositing it in a qualified account on the first day of the following year. With increasing marginal tax rates, the increased tax liability from increasing the tax base from zero to \$1,000 in the current year will be much smaller than the reduction in tax liability from the slightly greater than \$1,000 reduction in tax base in the following year, when taxable consumption is much higher.

Alternatively, the individual might have taken a \$1,000 deduction by depositing money in a qualified account in the last day of the previous year, leaving only \$19,000 in assets outside qualified accounts in the year in question. Again, the increased tax liability from a \$1,000 increase in tax base in the year in question would be smaller than the reduced tax liability from a \$1,000 reduction in tax base through taking the deduction in the previous year, when taxable consumption is much greater than zero.

Thus, with increasing marginal rates, the taxpayer who uses the asset flexibility features of the model cash flow tax to acquire a year of tax-free consumption pays for that privilege. The present value of his tax liability would be increased in either prior or future years by an amount greater than the present value of tax saving in the "tax-free" year.

<u>Uncertain Outcomes: A Problem with the Tax-Prepayment Approach</u>

<u>Tax Liability Can Be Independent of Outcome for Risky Investments</u>. The major disadvantage of allowing a wide variety of financial assets to be purchased <u>outside</u> qualified accounts is that some large gains would go untaxed. When an asset has been purchased through a qualified account, the government could be viewed as participating in the investment,

by allowing a tax deduction, and also participating in the return on the investment, by taxing the gross proceeds. For assets purchased outside of qualified accounts, however, the investment would not be deducted and the entire proceeds of the investment could be liquidated for consumption purposes tax-free.

If taxes were proportional, the after-tax rate of return would be the same in both cases. With qualified accounts, the Government in a sense would be a partner in the investment, sharing in the cost and appropriating a fraction of the return. When the tax is prepaid, however, the Government "share" in the returns would be zero. For assets bought outside of qualified accounts, large winners would not pay a higher tax and losers would not receive a loss offset. Although both types of tax treatment would allow investors equal opportunity to earn after-tax dollars, the tax treatment of assets purchased outside of qualified accounts would not distinguish between winners and losers of investment gambles. Thus, lucky investors might become very rich and owe no additional tax liability on future consumption of their wealth, if the initial investment were tax prepaid. Conversely, unlucky investors will have prepaid a tax on expected returns and will then obtain no deduction for the losses they incur.

A second potential problem with tax-prepayment of returns from assets would arise if tax rates were subsequently increased sharply -- for example, to finance a war. In that case, individuals who had prepaid tax on assets at the lower rates would escape taxation at the higher rates even if they were using the proceeds of profitable investments to finance current consumption. Of course, in making the tax-prepaid investments, those individuals ran the risk that tax rates might have been lowered, in which case they would have reduced their tax liability by buying assets through a qualified account.

It may be viewed as desirable in view of these problems to modify the current proposal by restricting, or even eliminating, the provision for purchase of income-earning assets outside of qualified accounts. One possible compromise would be to force all "speculative" investments, i.e., land, stocks, etc., to be purchased through qualified accounts but to allow the tax-prepayment option for fixed interest securities and savings deposits.

Consumer Durables. A similar problem would exist for consumer durables. Because consumer durables could not be purchased using qualified accounts, unanticipated increases in the value of consumer durables would be untaxed and there would be no tax offset for unanticipated losses. For example, if the value of an individual's house doubled in a year, his tax liability would not be affected. The option of requiring qualified-account treatment is not available here, as it is in the case of financial assets, because of the difficulty of measuring the value of the consumption services these assets provide.

No Optimal Treatment for Nonfinancial Business Assets

As explained above, investments in individual businesses would be eligible only for tax treatment on a current cash flow basis. All outlays for the business would be eligible for deduction, while all net receipts would be subject to tax. The reason for not allowing the alternative "tax-prepayment" treatment is that it is sometimes difficult to distinguish between the profits and wages of individual businessmen. If profit alone were exempted from tax, the businessman would have an incentive to avoid tax on the value of his labor services by paying himself a low wage and calling the difference return from investment. This problem would exist for individual proprietorships and possibly for small partnerships and closely held corporations. For such enterprises, all net receipts should be taxable and outlays for capital goods should be eligible for immediate deduction.

Table 1 below summarizes the proposed rules for tax treatment of financial assets, durable goods, loans, and family business enterprises. Note that the only restrictions are that all investments in a family business must be treated as if they were purchased in qualified accounts and consumer durable goods could not be purchased through qualified accounts. Financial assets could be purchased, and loans obtained, either through qualified accounts or outside of the system.

Table 1

Summary: Tax Treatment of Assets Under Cash Flow Tax

	Qualified Accounts	Accounts Outside of System
1. Financial Assets	purchases deductible; all withdrawals of earnings and principal taxed	purchases not deductible; interest and return of capital not taxed
2. Durable Goods	not available	purchases not deductible; sales not included in tax base
3. Loans	receipts in tax base; repayments deductible	receipts not in tax base; repayments not deductible
4. Family Business*	all outlays deductible, including capital outlays; all receipts taxed	not available

* Includes a limited class of small businesses owned and operated by the same person(s).

DIFFERENCES BETWEEN CASH FLOW AND COMPREHENSIVE INCOME TAXES: SPECIFIC PROVISIONS

Pension Plans and Social Security

Under the cash flow tax, all contributions to pension plans may be viewed as contributions to qualified accounts, whether by the employee or by the employer. By this logic, contributions would not be included in the tax base, while retirement benefits would be included in full. Similarly, all contributions for Social Security would be excluded from the tax base, while all Social Security retirement benefits would be taxable. There would be no need, under the cash flow tax, to compute the income on pension funds attributable to individual employees because the accumulation would not be subject to tax.

Life Insurance

Both term life insurance and whole life insurance would be treated differently under the cash flow tax than under the comprehensive income tax.

With term life insurance, there is no investment income and, thus, no expected change in net worth. Under the comprehensive income tax proposal, premiums for term life insurance, whether paid by the employer or the employee, would be included in the insured's tax base, while proceeds from term life insurance policies would be tax-exempt. The general principle of treatment of gifts under a cash flow, or consumption, base tax argues for a different treatment. Term life insurance may be viewed as a wealth transfer from the policyholder to the beneficiary. Purchase of a term life insurance policy lowers the lifetime consumption of the policyholder and raises the expected lifetime consumption of the beneficiary. Thus, a cash flow tax that taxes consumption of individuals should not tax premiums paid by the policyholder but should include proceeds from a term life insurance policy in the tax base of the beneficiary. In practice, this would mean that employer contributions to term life insurance would not be imputed to the tax base of the policyholder, while term life insurance premiums paid directly by the policyholder would be deductible.

Whole life insurance poses a different issue, although it would receive the same treatment as term insurance under the cash flow tax. A whole life insurance policy does provide investment income to the policyholder in the form of an option to continue to buy insurance at the premium level appropriate for the initial year. Under a cash flow tax, unlike the comprehensive income tax, the increase in the value of the option would not need to be computed for tax purposes because it would represent a change in net worth and not in consumption. However, if the individual cashed in the option value, the receipts from this transaction would be included in the cash flow tax base.

Under the model cash flow tax, all premiums paid by policyholders for whole life insurance would be tax deductible, while premiums paid by employers for policyholders would not be imputed to policyholders' tax bases. All receipts from life insurance policies, whether in the form of cash surrender value to policyholder or proceeds to beneficiaries, would be included in the tax base of the recipient.

State and Local Bond Interest

Under the model cash flow tax, State and local bond interest for securities not purchased through a qualified account would remain tax-exempt, as under the present law. However, as with the comprehensive income tax proposal, State and local bonds would lose their special status relative to other assets. Under the comprehensive income tax, these bonds would lose their special status because their interest would become taxable. Under the cash flow tax, the bonds would lose their special status because returns from all other assets would also become tax-exempt.

If State and local bonds were purchased through a qualified account, all contributions to the account would be deductible from the cash flow tax and all withdrawals from the account would be subject to tax. Thus, the purchase price of a State or local bond would be deductible, while withdrawals of interest payments and principal from the bond to pay for consumption would be subject to tax.

Interest Paid

Under the comprehensive income tax, all interest paid would be tax deductible because such outlays represent neither consumption nor additions to net worth. This would include interest payments for mortgages on owner-occupied homes. Under the cash flow tax, however, if a loan were taken through a qualified account, the initial proceeds of the loan would be taxable, while subsequent interest and principal repayments would be tax deductible. In present-value terms, the net effect of a loan on the tax base would be zero.

Corporate Income

Corporations would not be taxed as entities under either the cash flow tax or the comprehensive income tax. However, under the cash flow tax, there would be no need to impute undistributed income to individuals because taxes would be assessed only on funds available for personal consumption. Consequently, a single cash flow tax applied at the household level could be accomplished without the rules for integrating corporate and household accounts that are conspicuous features of the model income tax.

The treatment of returns from corporate activity under the cash flow tax would be exactly the same as the treatment of returns from other kinds of investments. There would be no separate tax at the corporation level. Individuals would be permitted to purchase corporate stock through qualified accounts held with brokers. The initial purchase price would be deductible from the tax base at the time of purchase, and subsequent withdrawals from the account as dividends received, return of capital, or proceeds from the sale of stock would be added alike to the tax base. For stock purchased outside of a qualified account, no deduction would be allowed for purchases, and neither dividends nor proceeds of future sales would be added to the tax base. Capital gains and capital losses would, therefore, have no tax consequences.

Capital Gains and Losses

Under the cash flow tax, there would be no need to keep records of the basis of asset purchases to compute capital gains. As explained above, when assets are purchased outside of qualified accounts, capital gains would be exempt from tax and capital losses would not be deductible. If assets are purchased within qualified accounts so that a deduction may be taken for the initial purchase price, no distinction would be made between the part of the sale that represented capital gain and the part of the sale that represented return of basis. In this latter case, the full amount of the sales proceeds, if not reinvested, becomes part of the tax base. The size of the capital gain would affect the amount of withdrawals for future consumption. Hence, when qualified accounts are used, the size of capital gains would have tax consequences even though no explicit calculation of gains (or losses) is necessary.

Because the cash flow tax does not tax accumulation, the issues of deferral, inflation adjustment, and the appropriate rate of tax on capital gains need not be considered, as they were in the discussion of a comprehensive income tax. The concept of deferral of tax would be relevant for the cash flow tax only if one could postpone without interest the tax liability associated with current consumption. Similarly, the value of assets or changes in the value of assets, whether related to general inflation or not, would not be relevant for the cash flow tax until they are withdrawn to finance consumption.

Business Income Accounting

Income accounting for any individual's business under the cash flow tax would be strictly on a cash accounting basis. The individual would have to compute in any year net receipts from operating the business. To perform this computation, he would add to the sale of goods and services during the accounting year any receipts from borrowing and would subtract the purchases of goods and services from other firms, wages paid to employees, interest paid to suppliers of debt finance, and all purchases of plant and equipment. Net receipts calculated by this method would be included in the individual's tax base, if positive, and would be deducted, if negative.

Note that the major difference between the cash flow tax and the comprehensive income tax with respect to business accounting is the treatment of assets. Under the cash flow tax, purchases of assets would entitle the businessman to an immediate deduction for the amount of purchase. Under the comprehensive income tax, deductions each year would be limited to a capital consumption allowance (depreciation), which estimates the loss in value during the year of those assets.

Also, business loans would be treated differently under the cash flow tax. All receipts of loans to a business would be included in the base, while interest and amortization payments would be deductible. Under the comprehensive income tax, loan receipts and amortization payments would have no tax consequences; only the interest payments would be deductible. When the proceeds of the loan are used immediately to purchase materials or services for the business, the deduction allowed under the cash flow tax just matches the addition of loan proceeds to the base.

For partnerships, the rules are simpler. A partnership would be required to report the annual cash contribution of each owner to the business and the annual distribution to each owner. The difference between distributions from partnerships and net contributions to partnerships would enter the individual owner's tax base. If the owner sold his shares, it would enter the tax base as a negative contribution.

SPECIAL PROBLEMS: PROGRESSIVITY, WEALTH DISTRIBUTION, AND WEALTH TAXES

The cash flow tax outlined in this proposal would tax consumption but not individual accumulation of assets. People are likely to conclude that such a tax would be regressive and that it would encourage excessive concentration of wealth and economic power. This section examines both these concerns, showing that concern about regressivity is a misconception and suggesting that the cash flow tax could be complemented in any desired degree by a transfer tax to influence wealth distribution. The complexities in the tax treatment of transfers at death caused by the existence of two kinds of financial assets are discussed below and some potential solutions are proposed.

Progressivity of the Tax

Exemption of Capital Earnings. The assertion that a consumption base tax is regressive stems from the fact that wealth is concentrated among relatively few households as compared to labor earnings. Because the cash flow tax is equivalent in present-value terms to exemption of earnings from capital, it would necessarily tax labor earnings more heavily to raise the same revenue. Thus, it might appear that the cash flow tax is a way of shifting the tax burden to the wage-earner class and relieving the wealthy taxpayer.

Such criticism of the cash flow tax may be superficially plausible but it is misleading on several grounds. First, much of what is generally labeled capital income is really a reward for postponing immediate consumption of past wages. Laborers as a class do not necessarily lose when the tax rate applied to wages immediately consumed is raised to enable forgiveness of taxes on the returns for saving out of wages. Second, the only other source of funds for investment aside from wages is transfers received (including inheritances), and these would be subject to tax at the same rate schedule applied to labor earnings under the cash flow tax. (This point is elaborated below.) Finally, the progressivity of any individual tax is to a large degree determined by the rate structure. The choice between a comprehensive income and a consumption base is independent of the degree of vertical progressivity of the rate structure.

Transfers of Wealth. The mechanism by which gifts and inheritances would be included in the tax base is simple. In order to be eligible for deduction by the donor, all gifts would have to be included in the tax base of the recipient. Gifts would be recorded only if they were transfers between taxable entities. Thus, a gift of a father to his 9-year-old son would not be included in the family's taxable receipts (unless it were removed from a qualified account). When the son left the family unit, say when he turned 26, he would become a separate taxpayer. At that point, all accumulated wealth from past gifts and inheritances would be included in his initial tax base and deducted from the family's base. If the initial base were large, the individual would have an incentive to purchase a qualified account to avoid a steep progressive tax, but would have to pay tax on subsequent withdrawals for consumption out of that account. Thus, an individual would not have the opportunity to realize tax-free consumption from a past inheritance.

Similarly, if the family's deduction for transfers to the son were large, the family would have an incentive to withdraw assets from a qualified account and treat such assets thereafter as held outside a qualified account. The family need suffer no adverse tax consequence, thereby.

The taxation of gifts and accessions to the donee and the deduction of itemized gifts by the donor are a logical, integral part of the cash flow tax system necessary to assure that the tax base is related to the lifetime consumption of every individual.

To see how inheritances would be included in the tax base of a cash flow tax, consider the following example. Suppose a man died on January 2, 1977 at the age of 70, leaving $300,000 in qualified accounts to his 35-year-old son. The tax base of the decedent in 1977 included a $300,000 withdrawal from the qualified account in receipts and a $300,000 deduction for the bequest of funds, for a net tax base of zero. The tax base of the son included the receipt of $300,000. With progressive rates, it is likely that the son would wish to deposit a large part of the $300,000 in a qualified account, paying tax only as the money was withdrawn for consumption.

A difficulty would arise if the $300,000 of the decedent, or a fraction thereof, were held outside a qualified account. While the tax treatment of the recipient's inheritance would be the same ($300,000 of receipts), the estate of the decedent has a large deduction, possibly with no current tax base to offset. The estate might then be entitled to a tax refund before the estate were divided up. This treatment would be appropriate because the decedent had, in effect, prepaid tax for consumption of the proceeds of the investment that was never consumed in his lifetime. However, an amount, or rate, of refund must be specified. One possibility would be to allow a refund to the estate equal to the value of investment assets outside of qualified accounts multiplied by the rate applicable to the lowest tax bracket. An alternative solution would be to give no refund at all. The inability to consume expected proceeds of a tax-prepaid investment because of death may be viewed as one of the risks an individual knowingly undertakes when he invests in a tax-prepaid asset. This treatment would also provide further incentive for investments to be made through qualified accounts.

If initial financial endowments and receipts of transfers are included in the tax base, there would be no difference in tax treatment between an individual who invests an inheritance and one who invests his savings out of wages. Neither would have any additional tax until he consumes the amount invested or the earnings. In effect, earnings from investment could be viewed as a reward for deferring consumption from wage income or inheritance. If the rate structure were appropriately progressive, so that the high-wage earners with large accessions would be paying a significantly higher tax than low-wage earners with small accessions, there would seem to be no particular reason to discriminate in tax liability between persons with different patterns of lifetime consumption. Viewed in that manner, the cash flow tax would not favor the wealthy but would favor, relative to a comprehensive income tax, those individuals who, at any given income level, chose to postpone consumption.

Lucky Gambles. Another potential objection to the proposed system on progressivity grounds is the opportunity it would afford individuals to acquire wealth by a lucky investment gamble, and to have paid only a small tax on the amount wagered. Some regard this possibility as inequitable. As noted above, this possibility could be largely avoided, at a price in complexity and compliance costs, by taxing the future returns on some or all investments that are not made through qualified accounts, or by restricting the types of investment that could be made outside of qualified accounts.

Accumulation of Wealth. The second major concern about a cash flow tax is that it would place no restraint on the accumulation of wealth. Although all consumption out of accumulated wealth would be taxed, the cash flow tax, compared with an income tax, would make it easier for individuals to accumulate wealth. The effect of this on the distribution of wealth in the United States cannot be forecast precisely. Presumably, individuals at all levels would tend to hold more wealth, so that the dispersion of wealth might either increase or decrease. At the same time, there might be an increase in the size of the largest wealth holdings.

The cash flow tax -- with wealth transfers deductible to the donor and included in the tax base of the recipient -- would be a tax on the standard of living of individuals (with some exemption, or credit, for a small consumption amount). Like the model comprehensive income tax, it could be converted to the concept of "ability-to-pay" discussed in chapter 2. According to that concept, wealth transfers would be regarded as consumption by the donor and included in the tax base of both donor and recipient. To accomplish this conversion, gifts would not be deductible to the donor and bequests would be taxed as a use of lifetime receipts.

A simpler approach, and one that is more consistent with present policies, would be to retain the estate and gift tax as the principal instrument for altering the distribution of wealth. Such a tax, which is levied according to the situation of the donor, would be a logical complement to the model cash flow tax. The existence of a separate estate and gift tax would not damage either the basic simplicity inherent in the treatment of assets under the cash flow tax or the neutrality in tax treatment of those individuals with the same endowment who have different time patterns of labor earnings or consumption. Under this option, all features of the cash flow tax would remain exactly as explained above, except for the wealth transfer tax. Tax rates on gifts and bequests could be designed to achieve any desired degree of equalization in initial wealth of individuals.

INFORMATION ON SAMPLE TAX FORM FOR CASH FLOW TAX

Filing Status

1. Check applicable status

   a. Single

   b. Married filing joint return

   c. Unmarried head of household

   d. Married filing separately

Exemptions

2. If applicable, enter 1 on line

   a. Regular

   b. Spouse

3. Number of dependent children

4. Total exemptions (add lines 2a, 2b, 3)

Receipts

5a.1/ Wages, salaries, and tips of primary wage earner (attach forms W-2)

b. Wages, salaries, and tips of all other wage earners (attach forms W-2)

c. Multiply line 8b by .25; if greater than $2,500, enter $2,500

d. Included wages of secondary worker (subtract line 5c from 5b)

e. Wages subject to tax

6. Gross business receipts (from schedule C)

7. Gross distributions from partnerships (from schedule E)

8. Distributions from pension funds and trusts (includes social security benefits)

9. Gifts and inheritances received

10. Withdrawals from qualified accounts (if positive)

11. Disability pay, unemployment compensation, workmen's compensation, sick pay, public assistance, food stamp subsidy, fellowships, and other cash stipends

12. Alimony received

13. Total receipts (add lines 5c, and 6 through 12)

Deductions

14. Gross business expenses (schedule C)

15. Contributions to partnerships (schedule E)

16. Contributions to trusts

17. Deposits in qualified accounts (form S-2)

18. Other deductions (schedule A)

19. Total deductions (add lines 14 through 18)

Computation of Tax

20. Cash flow subject to tax (subtract line 19 from line 13)

21. Basic exemption (enter $1,500)

22. Family size allowance (multiply line 4 by $800)

23. Total exemption (add lines 21 and 22)

24. Taxable cash flow (subtract line 23 from line 20)

25. Tax liability (from appropriate table)

26. a. Total Federal cash flow tax withheld

    b. Estimated tax payments

    c. Total tax prepayments (add lines 27a and 27b)

27. If line 26 is greater than line 27c, enter BALANCE DUE

28. If line 27c is greater than line 26, enter REFUND DUE

Schedule A -- Deductions

Taxes

1. State and local income taxes

Gifts, Charitable Contributions, and Alimony

2. Gifts or donations to an identified taxpayer or entity (itemize)

3. Alimony paid

Cost of Earning Income

4. Union dues

5. Child care expenses (only for secondary workers or single adult households)

6. Multiply line 5 by one-half

7a. Enter line 6 or $5,000, whichever is smaller

b. Enter line 7a or line 4b (line 4a for unmarried head of household) from form 1040, whichever is smaller

8. Other costs (itemize)

9. Add lines 4, 7b, and 8

10. Subtract $300 from line 9

11. If line 10 positive, enter line 10; if line 10 negative enter 0

12. Add lines 1, 3, and 11; enter on form 1040, line 18

Schedule C (Business Receipts and Expenses)

Like current schedule C except

Line 5 total outlays for purchases of assets

Enter line 5 (total income) on form 1040, line 6

Enter line 20 (total deductions) on form 1040, line 14

Schedule E -- Note: Partnership will have to send information on form 1065 of gross distributions and gross contributions

Form S-2's -- Supplied by brokers of qualified accounts

1. Total deposits

2. Total Withdrawals

3. Net Withdrawal (line 2 minus line 1), if positive

4. Net Deposit (line 1 minus line 2), if positive

1/ Wages reported by the employer would exclude employee contributions to pension plans, disability insurance, health insurance and life insurance plans. Wages would also exclude the employee's share of payroll taxes for Social Security (OASDHI), and the cash value of consumption goods and services provided to the employee below cost.

Chapter 5

QUANTITATIVE ANALYSIS

This chapter presents quantitative analyses of the two model plans and compares them to present law. The first section discusses briefly the nature of the data base used to develop and simulate the effects of the model plans. The chapter then discusses the estimated magnitudes of the various income concepts used in the report and the following section uses these data to derive exemption and rate structures for the comprehensive income tax consistent with achieving present revenue yield. This is followed by estimates of the magnitude of the cash flow tax base. Finally, the chapter develops specific provisions of the cash flow tax -- exemptions and rates -- and compares the two model plans and current law.

THE DATA BASE

The first step in the quantitative analysis of the reform plans was to construct a data base representative of the relevant characteristics of the U.S. population. A file of records was created and stored in a computer, with each record containing information for a tax return filing unit, such as the amount of wages earned by the member or members of that unit, dividends received, etc. In all, some 112,000 records are contained in the file.

Each of these records stands for a group of taxpayers with similar characteristics. Thus, a given record may be taken to represent 100 or 1,000 filing units in the U.S. population as a whole. To simulate the effect of some change on the whole population, the effect on each record in the file is calculated and multiplied by the number of units represented by that record.

The records in the file were constructed by combining information from two separate sources: a sample of 50,000 tax returns provided by the Statistics Division of the Internal Revenue Service, and a sample of 50,000 households (representing about 70,000 tax filing units) from the Current Population Survey of the Census Bureau. The two data sets were needed because the reform plans base tax liabilities on information not now provided on tax returns. Furthermore, a realistic picture of the U.S. economy requires obtaining characteristics of "nonfilers," individuals and families who are not obliged to file income tax returns because they do not have sufficient taxable income.

To represent the incomes generated by the U.S. economy, these two data sets were merged by matching records of taxpayers from the sample of tax returns with records of participants in the Current Population Survey. Since confidentiality strictures on the release of identifier information from each of these sources prevented the literal pairing of data on any given taxpayer, the matching was accomplished by matching records of similar characteristics (age, race, total income, etc.). The resulting file of records is not quite the same as if the information in each record had been obtained for the same individual or family. For technical reasons, it has been possible to achieve a more faithful representation of the U.S. population by using some records more than once. Therefore, the number of records in the final data file reflects an artificial expansion of the number of records in the two original files.

Both samples use 1973 data. Because more recent data would be more relevant, the 1973 population and its attributes were adjusted by extrapolation to represent the 1976 population.

The resulting simulations of the U.S. population should be interpreted with some sense of the nature of the data set. The original data were subject to the usual sampling and processing errors. The processes of merging the two data sources and extrapolating the resulting file to a later year represent further sources of error. Furthermore, many items needed were not recorded in either of the original surveys, and had to be estimated and imputed to each record. For these reasons, the file should not be regarded as a perfect description of the U.S. population.

Nonetheless, the data have been assembled with great care. In some cases, adjustments were made to insure that the data file produces aggregate figures (say, on total wages paid in the economy) in line with those derived from independent statistical sources. In other cases, such aggregates were used to "validate" the file; that is, to check its reasonableness. By and large, the data pass the test of these checks, and the file may be used with some confidence. At the same time, it would be a mistake to equate the data file with the real world, for example, by being concerned about small differences in a simulated tax burden.

ESTIMATION OF THE INCOME CONCEPTS

The first few tables present various definitions of income that were used in the computer simulations.

Table 1 describes adjusted gross income, or AGI, the broadest before-tax concept used for the present income tax. Like all of the income concepts, its source is primarily current money wages and salaries. The remainder, labeled "other AGI" in the table, comes from net self-employment and partnership income, capital income, such as interest and dividends, capital gains, and miscellaneous other elements of income. The table shows that "other AGI" is a larger share of adjusted gross income in the highest income classes.

The data in table 1 cannot be compared directly with AGI as reported on tax returns because information is included for nonfilers as well as filers. Thus, table 1 shows adjusted gross income that would be reported if all families and individuals were required to file tax returns under current law, and displays the distribution of all such filing units by income class.

The income classes in table 1 are defined in terms of "economic income," the broadest before-tax income concept used in this report. As discussed more fully below, this income concept is even broader than the tax base described in the comprehensive income tax proposal of chapter 3. Economic income is used as the classifier in the early tables of this chapter. In later tables, other classifiers are used for reasons explained below.

Adjusted gross income is not the base of the present individual income tax. Starting from AGI, taxpayers are allowed several kinds of deductions to arrive at income subject to tax. Table 2 displays the major elements of the present individual income tax base. Again, as in table 1, the information shown includes data for nonfilers as well as filers, although nonfilers do not add anything to the aggregate taxable income under present law because their exemptions and deductions reduce their taxable incomes to zero.

In each category of table 2, the amounts shown include only income that enters into the calculation of AGI. Thus, for example, portfolio income includes only one-half of

Table 1

Present Law

Adjusted Gross Income

(1976 levels)

Economic income class	Number of filing units 1/	Current money wage income	Other adjusted gross income	Total adjusted gross income
($000)	(... millions ....)	(.....................	$ billions	.......................)
Less than 0	0.2	0.9	-1.8	-0.9
0 - 5	38.0	29.5	12.2	41.7
5 - 10	19.5	81.3	20.6	101.9
10 - 15	13.9	117.4	16.1	133.5
15 - 20	12.1	151.9	16.3	168.1
20 - 30	15.0	261.0	25.8	286.8
30 - 50	7.1	157.1	34.4	191.5
50 - 100	2.3	56.0	30.9	86.9
100 or more	0.5	20.0	25.7	45.7
Total	108.6	875.1	180.1	1,055.2

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1/ Includes all filing units whether or not they actually file returns or pay tax under present law. The estimated number of filing units that do not currently file tax returns is 21.5 million; their adjusted gross income is $4.1 billion.

Table 2

Components of the Present Law Individual Income Tax Base

(1976 levels)

Economic income class	Net money wage income	Pension income	Self-employment income	Portfolio income	Deductions for State and local taxes	Miscellaneous income minus deductions	Total 1/	Tax base 2/	Standard deductions	Exemptions 3/	Present law income subject to tax
($000)	(........					$ billions					........)
Less than 0	0.8	0.2	-4.2	1.5	-0.1	0.2	-1.6	0.5	0.0	-0.1	0.4
0 - 5	29.2	5.5	0.1	4.9	-0.5	0.8	40.0	40.6	-26.3	-7.7	6.6
5 - 10	80.4	4.7	4.3	10.3	-1.9	-1.6	96.2	96.7	-28.7	-24.3	43.7
10 - 15	115.6	2.6	5.6	5.5	-4.1	-3.9	121.3	121.5	-19.2	-26.5	75.8
15 - 20	149.8	1.9	6.9	2.5	-7.3	-5.9	147.9	148.1	-14.6	-27.8	105.7
20 - 30	257.5	2.1	11.2	3.6	-15.2	-10.3	248.9	249.3	-16.9	-37.2	195.2
30 - 50	154.8	1.7	16.4	11.1	-12.1	-8.5	163.4	163.7	-5.4	-18.0	140.3
50 - 100	55.1	0.8	15.2	12.6	-6.1	-4.7	72.9	73.1	-1.5	-5.8	65.8
100 or more	19.7	0.3	9.8	14.2	-3.3	-3.7	37.0	37.3	-0.1	-1.4	35.8
Total	863.0	19.8	65.3	66.3	-50.6	-37.6	926.0	930.7	-112.7	-148.7	669.2

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Note: The amounts shown in each category include only the income that actually enters into adjusted gross income under present law.

1/ The amounts shown in this column are the sum of the amounts in the preceding columns.

2/ The amounts shown in this column differ from the amounts in the "total" column because of the exclusion of negative amounts in the total column for individual filing units.

3/ The amounts shown in this column exclude the value of exemptions that would reduce income subject to tax to below zero.

realized net long-term capital gains. As appropriate, expenses were netted against the associated income. Thus, wage receipts are net of the recognized expenses of earning it. Similarly, "portfolio income," consisting of interest, dividends, rent, estate and trust income, and realized capital gains, is net of interest expense. "Miscellaneous income minus deductions" is an amalgam of income not otherwise classified, net of all deductions not directly allocable to particular income sources. Its negative value results from the fact that the itemized deductions allowed under present law and not separately deducted from other components of income are much larger than the miscellaneous income items included here, such as State income tax refunds, alimony received, prizes, and the like.

The present tax base is shown in the column labeled "tax base." Exemptions and standard deductions (but not itemized deductions) are thus treated here as part of the rate structure. As table 2 shows, the tax base under present law is somewhat larger than AGI less itemized deductions because negative net income is never allowed to reduce the tax base for an individual return to below zero. Similarly, the value of the standard deduction and exemptions cannot reduce income subject to tax to below zero.

Table 2 indicates that present law income subject to tax is only about 63 percent of adjusted gross income. Exemptions, the standard deduction, and itemized deductions account for this difference.

The major components of economic income are tabulated separately in table 3. Many of these components require some explanation. "Deferred compensation" consists of employer contributions to pension and insurance plans, including social security. "Household property income" consists of rents, interest income net of interest expense, estate and trust income, dividends, capital income of the self-employed, and imputed returns from homeownership, life insurance policy reserves, and pension plans. "Noncorporate capital gains accruals" represents the growth in the real value of assets held by individuals except for corporate stock. The latter accruals are assumed to be included in corporate retained earnings, as indicated in the next column. In constructing the simulation of the U.S. taxpayer population, corporate retained earnings were allocated to shareholders in proportion to their dividend income.

Table 3

Economic Income

(1976 levels)

Economic income class	Net money wage income	Deferred compensation	Self-employment labor income	Household property income	Noncorporate capital gains accruals	Corporate retained earnings	Corporation income tax	Implicit taxes	Net transfers	State and local income tax deductions	Economic income
($000)	(..					$ billions	....				)
Less than 0	0.8	0.0	0.1	-3.9	0.1	0.1	-0.6	0.4	0.3	-0.1	-2.8
0 - 5	29.2	2.6	1.0	4.3	0.6	0.3	0.9	-0.5	41.4	-0.1	79.9
5 - 10	80.4	8.8	4.7	11.5	1.4	1.1	2.5	-1.2	34.3	-0.3	143.2
10 - 15	115.6	14.4	5.9	11.6	1.8	1.0	2.6	-1.0	20.8	-1.0	171.9
15 - 20	149.8	18.7	9.0	14.3	2.9	1.1	3.4	-0.7	15.1	-2.1	211.5
20 - 30	257.5	33.7	14.8	30.4	5.2	2.3	7.1	-0.8	17.8	-4.9	362.9
30 - 50	154.8	20.9	17.7	44.8	6.2	3.4	10.5	0.3	9.6	-4.7	263.5
50 - 100	55.1	6.8	13.9	51.9	5.8	4.0	12.3	2.6	3.0	-3.0	152.4
100 or more	19.7	1.6	9.4	28.5	3.6	6.2	7.5	0.8	10.2	-2.0	85.4
Total	863.0	107.6	76.5	193.3	27.7	19.6	46.0	0.0	152.4	-18.1	1,467.9

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The entries in the columns "corporation income tax" and "implicit taxes" are derived from concepts that may not be generally familiar. Since the corporation income tax is before-tax income that would be received by individuals were it not taken by taxation first, this tax is included in before-tax economic income. The burden of the corporation income tax was assumed to fall evenly on all individual owners of capital. The logic underlying this position is that, in a market system, capital is allocated to equalize rates of return. Because of the corporation income tax, the capital stock in the corporate sector is smaller than it would be otherwise, and the before-tax rate of return higher. By the same reasoning, the capital stock in the noncorporate sector is higher and rates of return lower than they would be otherwise. Through this tax-induced movement of capital from the corporate to the noncorporate sector, the burden of the corporate tax, that is, its effect on reducing after-tax returns, is spread across all capital income.

Cases can be constructed in which labor income as well as capital income bears the real burden of the corporation income tax, but for the simulations presented in this chapter, this tax has been allocated in proportion to all capital income, with the result shown in table 3. Capital income in this table is composed of household property income, noncorporate capital gains accruals, corporate retained earnings, corporation income tax, and implicit taxes.

The "implicit taxes" shown in table 3, although small in amount, illustrate an important phenomenon affecting the progressivity of the tax structure. Implicit taxes, which are quite subtle in concept, are best explained by an example. Present law does not tax the interest on municipal bonds; therefore, a holder of such bonds receives less interest than he might receive if he invested his funds in fully taxable securities. The difference between what he receives and what he could receive is his implicit tax. It is <u>implicit</u> because no revenue is paid to the U.S. Treasury. It is nonetheless a <u>tax</u> because the bondholder's after-tax income is reduced in the same way as if he paid a tax. Of course, the implicit tax may be lower than the actual tax payable on fully taxable bonds, and this is why tax-exempt securities are attractive to high-bracket taxpayers.

Other persons receive benefits from the tax-exemption of municipal bonds. The attractiveness of municipal bonds draws capital out of the private sector, thereby increasing slightly the before-tax return to investors in other forms of capital. The increase in their return is an implicit subsidy or negative implicit tax. If total income is kept constant in the economy, and efficiency losses ignored, the positive and negative implicit taxes must balance exactly in the aggregate, although not for any particular taxpayer or any income class.

There is an implicit tax corresponding to many tax benefits to capital income in the current tax structure. The simulations included implicit taxes for real estate, agriculture, mining, and capital gains arising from corporate retained earnings and tax-exempt bonds. In each case, the tax preference accorded to the activity in question attracts capital that would otherwise be applied elsewhere, and thus reduces the before-tax returns. Since the advantages of these tax benefits -- even taking into account the reduced before-tax returns -- are worth more to those in high tax brackets, positive implicit taxes are paid by higher income taxpayers. Therefore, implicit taxes make the present tax structure as measured by effective tax burdens somewhat more progressive than it may at first appear.

Nonetheless, some positive implicit taxes are borne by filing units in the below-zero income class. This income class consists of households sustaining real economic losses. To the extent that these losses occurred in tax-preferred activities, they are even greater than they would have been in the absence of the tax preference, and, accordingly, implicit taxes are generated for this income class.

"Net transfers" include income support in cash and in kind and the excess of accruing claims to future social security benefits over current employer and employee contributions.

Finally, economic income is net of some State and local taxes. Since property taxes are netted in calculating capital income in the previous columns and sales taxes as discussed in chapter 3 are treated as consumption outlays, only State and local income taxes are subtracted here.

Economic and Comprehensive Income

Economic income is an accrual concept. However, as chapter 3 makes clear, a pure accrual income concept is not practical as a tax base. Table 4 shows the difference between economic income and "comprehensive income," which was the starting point for developing the tax base used in the comprehensive income tax proposal.

Four categories of adjustments are involved in moving from economic income to comprehensive income. The first adjustment is for pensions. Economic income includes the accruing value of future pension benefits for both private pensions and social security. Comprehensive income, however, is on a realization basis in that actual social security and pension benefits, rather than their accruing value, are included. The difference is shown in column 2.

The second adjustment is for homeowner preferences and agricultural income. Comprehensive income does not include the imputed rental income from owner-occupied housing. Furthermore, all agricultural activity cannot reasonably be placed on the accrual accounting standard applied in calculating economic income. The third adjustment accounts for the fact that capital gains on noncorporate assets are included in comprehensive income when realized rather than accrued. Finally, in-kind transfers, such as Medicaid, are not included in comprehensive income. As table 4 makes evident, the partial shift from an accrual to a realization concept of income results in a substantial shrinkage in the value of the income measure that serves as the starting point for the model comprehensive income tax.

As discussed in chapter 3, it was principally the difficulties in measuring income on an accretion basis that underlay the decision to use comprehensive rather than economic income as the tax base. This decision also influenced the way in which taxpayers were classified and tax burdens calculated in the simulations. While economic and comprehensive income are generally highly correlated, there are some classes of taxpayers for whom income as accrued and income as realized are quite different. This is especially the case for taxpayers receiving pension income, who are drawing down their past accruals of pension plan assets. Such taxpayers would find themselves in relatively low economic income classes but would be in higher comprehensive income classes as a result of realizing the benefits of past contributions to pension plans.

Economic and Comprehensive Income

(1976 levels)

Economic income class	Economic income	Adjustments (subtract)				Comprehensive income
		Pensions	Nontaxed homeowner preferences and agricultural income	Non-corporate capital gains	In-kind transfers	
($000)	(................................ $ billions ....)					
Less than 0	-2.8	-0.2	0.1	0.1	0.1	-2.8
0 - 5	79.9	-18.4	1.0	0.4	6.4	90.4
5 - 10	143.2	4.6	2.1	0.9	4.0	131.6
10 - 15	171.9	21.5	4.4	1.1	1.5	143.4
15 - 20	211.5	26.2	8.3	1.7	0.8	174.5
20 - 30	362.9	43.7	15.9	3.1	0.8	299.4
30 - 50	263.5	24.5	10.7	3.7	0.4	224.1
50 - 100	152.4	7.0	3.6	3.5	0.1	138.3
100 or more	85.4	11.3	1.0	2.2	0.0	71.0
Total	1,467.9	120.1	47.2	16.6	14.1	1,269.9

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Table 5 presents a cross-tabulation by economic income and comprehensive income of the number of filing units receiving pensions in excess of $500. While this table indicates that pensioners in higher economic income classes are in higher comprehensive income classes as well, it also reveals that, in general, their comprehensive income tends to be larger than their economic income. If taxes were assessed on the basis of comprehensive income and filing units were arrayed by economic income class, the tax structure would appear less progressive. This is because pensioners, who are generally in lower income classes, have comprehensive income that exceeds economic income. During their earning years, both economic and comprehensive income are relatively high but economic exceeds comprehensive income.

Both of these effects tend to tilt the structure of effective tax rates as measured using economic income in the direction of lower effective rates on higher economic income and higher effective rates on lower economic income. What appears to be a phenomenon of the aggregate distribution of the tax burden is actually a matter of the timing of taxes at different points in the life cycle of the same taxpayer. A consequence of these lifetime effects, which are discussed in more detail later in this chapter, is that comprehensive income is a more meaningful classifier for analyzing a tax system using a realization basis. Hence, in the tables that follow, comprehensive rather than economic income is used to identify the income classes of the taxpayers. Even more desirable would be a comparison of lifetime tax burdens with lifetime income.

Present Law Tax

Table 6 displays the progressivity of the present income tax system, the total amount of revenue that it raises, and the effective tax rates by comprehensive income class. The individual income tax is only part of the present tax structure. The proposals in this report also would replace the corporation income tax and, by including virtually all income in the tax base, would reduce implicit taxes to near zero. Present tax burdens, however, include all three forms of tax. As shown in table 6, effective tax rates so derived rise continually with comprehensive income.

Table 5

Cross-Tabulation of the Number of Filing Units with Substantial Pension Income by Economic Income and by Comprehensive Income 1/

(1976 levels)

Economic income	Comprehensive income ($000)									
	Up to 0	0 - 5	5 - 10	10 - 15	15 - 20	20 - 30	30 - 50	50 - 100	100 or more	Total
($000)	(........				thousands				........)	
Less than 0	49.	22.	7.	4.	0.	0.	0.	0.	0.	81.
0 - 5	4.	9,705.	3,221.	526.	88.	33.	3.	0.	0.	13,581.
5 - 10	4.	453.	2,839.	1,539.	318.	70.	6.	0.	0.	5,230.
10 - 15	1.	61.	170.	1,080.	472.	172.	22.	0.	0.	1,978.
15 - 20	0.	27.	17.	152.	640.	382.	55.	1.	0.	1,273.
20 - 30	1.	22.	4.	13.	185.	914.	208.	12.	0.	1,360.
30 - 50	0.	10.	2.	1.	4.	118.	681.	77.	0.	894.
50 - 100	0.	6.	0.	0.	0.	0.	26.	276.	22.	331.
100 or more	0.	4.	2.	0.	0.	0.	0.	6.	55.	68.
Total	60.	10,311.	6,262.	3,316.	1,707.	1,689.	1,001.	372.	77.	24,796.

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1/ Pension income of $500 or more.

Table 6

Present Law Tax and Effective Tax Rates

(1976 levels)

Comprehensive income class ($000)	Individual income tax	Corporation income tax	Implicit taxes	Total present law income tax	Effective tax rate 1/
	(........................ $ billions			.........................)	(.. percent ..)
Less than 0	0.2	-0.6	0.4	0.0	-0.6
0 - 5	1.0	0.7	-0.3	1.4	1.7
5 - 10	9.5	2.5	-1.1	10.9	6.4
10 - 15	17.8	3.6	-0.9	20.5	9.9
15 - 20	22.9	4.3	-0.7	26.5	12.7
20 - 30	32.6	7.3	-0.8	39.1	15.4
30 - 50	22.8	10.1	0.5	33.4	19.8
50 - 100	16.5	11.3	2.5	30.3	25.2
100 or more	13.3	6.7	0.5	20.6	32.4
Total	136.6	46.0	0.0	182.6	14.4

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1/ Tax as a percentage of comprehensive income.

A Proportional Comprehensive Income Tax

It would be possible to replace the present individual and corporate income tax with a proportional or flat-rate tax on individuals, choosing the rate in such a way as to raise the same total revenue. A reasonable exemption could be allowed for a taxpayer and dependent, or the exemption could be eliminated altogether in favor of a lower rate. Two versions of a proportional tax on comprehensive income, raising the same revenue as the present income tax, are shown in table 7. One has no exemption and a tax rate of 14.35 percent of the comprehensive income base, and the other has an exemption of $1,500 per taxpayer and dependent and a flat rate of 19.35 percent of comprehensive income in excess of exemptions. Table 7 shows comprehensive income by income class, present law tax burdens, and the results of the two proportional rate plans. As compared to present law, both plans would result in a tax decrease for the higher income taxpayers and an increase for those with lower incomes. The plan that allows an exemption would come somewhat closer to the present distribution of tax burdens, but some form of graduated rates is required to achieve a close approximation.

THE MODEL COMPREHENSIVE INCOME TAX

Table 8 shows the steps from comprehensive income to the income subject to tax under the model comprehensive income tax plan and compares that amount to present law taxable income.

The first adjustment is for child care and secondary workers and applies to joint and head-of-household returns. Only 75 percent of the first $10,000 of earnings of workers other than the primary wage earner is included in income subject to tax. A deduction of one-half of child care expenses, up to a maximum deduction of $5,000, is allowed against wage earnings of unmarried heads of households and against the included wages of secondary workers on joint returns.

The combination of exemptions and structure of rates is designed to yield about the same total revenue, with about the same distribution by income class, as the present tax. The model comprehensive income tax would allow exemptions of $1,000 per taxpayer and dependent, plus $1,600 per return (half for married persons filing separately). The value of these exemptions is shown in table 8. A deduction for

Table 7

Distribution of the Tax Burden under Present Law and Illustrative Proportional Rate Income Taxes

(1976 levels)

Comprehensive income class	Comprehensive income	Amount of income tax under: Present law	Proportional rate of 14.35 percent	Proportional rate of 19.35 percent with exemption 1/
($000)	(............ $ billions	....	....	............)
Less than 0	-3.6	0.0	0.0	0.0
0 - 5	81.0	1.4	11.6	5.7
5 - 10	171.2	10.9	24.6	19.6
10 - 15	205.7	20.5	29.5	26.6
15 - 20	209.1	26.5	30.0	29.5
20 - 30	253.7	39.1	36.4	39.1
30 - 50	169.0	33.4	24.2	28.6
50 - 100	120.2	30.3	17.2	21.6
100 or more	63.5	20.6	9.1	11.9
Total	1,269.9	182.6	182.6	182.6

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1/ Exemption of $1,500 per taxpayer and dependent.

Table 8

Tax Base for Comprehensive Income Tax Proposal

(1976 levels)

Comprehensive income class	Comprehensive income	Child care and secondary worker provisions	Exemptions 1/	Comprehensive income subject to tax 2/	Present law taxable income	Change in taxable income
($000)	(...................................		$ billions	....		)
Less than 0	-3.6	0.0	0.0	0.0	0.8	-0.8
0 - 5	81.0	-0.1	-68.0	12.9	10.1	2.8
5 - 10	171.2	-1.5	-83.5	86.1	69.2	16.9
10 - 15	205.7	-4.4	-71.7	129.6	111.3	18.3
15 - 20	209.1	-6.6	-57.1	145.4	129.9	15.5
20 - 30	253.7	-8.2	-51.4	194.1	164.6	29.5
30 - 50	169.0	-3.1	-21.4	144.5	97.0	47.5
50 - 100	120.2	-1.0	-8.5	110.7	54.7	56.0
100 or more	63.5	-0.3	-2.0	61.2	31.7	29.5
Total	1,269.9	-25.3	-363.6	884.5	669.2	215.2

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1/ The amounts shown do not include the value of exemptions that, if allowed, would reduce comprehensive income subject to tax to below zero.

2/ Since comprehensive income subject to tax cannot be less than zero, it is greater than the sum of the first three columns by the amount of the negative income in the first comprehensive income class.

these amounts yields "comprehensive income subject to tax," the amount to which the rate schedule is applied in the model tax.

Table 8 also indicates the change in taxable income from current law as a result of using the model comprehensive income tax. The increase in income subject to tax is extremely large, approximately one-third of present taxable income. Such a substantial broadening of the tax base can permit a marked reduction in tax rates throughout the entire income range.

The rate structure for joint returns would be as follows:

Income Bracket	Marginal Tax Rate
\$ 0 - \$ 4,600	8 percent
\$ 4,600 - \$40,000	25 percent
Over \$40,000	38 percent

For single returns, the rate structure would be as follows:

Income Bracket	Marginal Tax Rate
\$ 0 - \$ 2,800	8 percent
\$ 2,800 - \$40,000	22.5 percent
Over \$40,000	38 percent

"Heads of households," as under present law, would pay the average of the amounts they would pay using the single and joint schedules.

The tax revenues that would be raised by this plan, and their distribution by income class, are shown in table 9, along with the corresponding information for the present tax. The agreement is quite close and the aggregate tax change for each income class is small. Table 10 shows tax liabilities by filing status under both the present law and the comprehensive income tax proposal. Again, the changes are small. The proposed tax plan would favor larger families

Table 9

Amount of Tax and Effective Tax Rates under the Present Law Income Tax and Model Comprehensive Income Tax

(1976 levels)

Comprehensive income class	Present law		Comprehensive income tax	
	Tax	Effective tax rate 1/	Tax	Effective tax rate 1/
($000)	(.. $ billions ...)	(.... percent ....)	(... $ billions ..)	(.... percent ....)
Less than 0	0.0	-0.6	0.0	0.0
0 - 5	1.4	1.7	1.0	1.3
5 - 10	10.9	6.4	10.4	6.1
10 - 15	20.5	9.9	20.5	10.0
15 - 20	26.5	12.7	27.0	12.9
20 - 30	39.1	15.4	40.1	15.8
30 - 50	33.4	19.8	32.6	19.3
50 - 100	30.3	25.2	31.2	26.0
100 or more	20.6	32.4	20.8	32.7
Total	182.6	14.4	183.7	14.5

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1/ Tax as a percentage of comprehensive income.

Table 10

Amount of Tax According to Filing Status under the Present Law Income Tax and Model Comprehensive Income Tax

(1976 levels)

Filing status	Present law income tax	Model comprehensive income tax
	(................. $ billions	................)
Single	32.3	32.3
Married filing separately	2.5	3.0
Head of household	6.4	6.9
Joint and certain surviving spouses	141.4	141.5
No dependents	54.3	57.3
One dependent	28.2	27.8
Two dependents	29.0	27.9
Three dependents	17.5	16.8
Four dependents	7.8	7.4
Five or more dependents	4.6	4.3
All returns	182.6	183.7
Returns with one or more aged	21.6	25.8

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slightly compared to present law. Filing units with one or more aged members would pay somewhat higher taxes because they would lose the extra age exemption and because social security cash grants are included in the tax base.

Although tax liabilities by income class and filing status do not change greatly on the average, the proposed comprehensive income tax would alter significantly the tax liabilities of many individual taxpaying units. Those whose income is not fully taxed under current law would pay more tax under this comprehensive plan, while others would benefit from the generally lower rates. Also, many would be relieved of the burden of double taxation on corporate income.

Table 11 shows the number of filing units in various categories that would have their tax liabilities either increased or decreased by more than 5 percent of present law tax or by more than $20. The average amount of decrease for those returns with decreases is almost $380, while the average amount of increase among the gainers is nearly $650. The average gains and losses are similarly large for virtually all the categories shown on the table.

This finding of large average amounts of gains and losses should be interpreted with great care. It is inevitable that any such tax change will involve substantial redistribution within income classes even if the total tax collected within each class remains the same. Furthermore, to some degree, the simulated comparisons are spurious because it is not proposed to adopt the model plan overnight. Indeed, the existence of a large number of gainers and losers is in itself evidence that careful transition rules are needed to facilitate the movement toward a reformed tax structure.

It should also be noted that the nature of the data base biases the result in the direction of a finding of extensive redistribution. This is so because the individual records in the file of taxpayers in the simulation were constructed by matching information about different individuals in the taxpayer and Current Population Survey samples. As a result, current and new tax liabilities for a given record in the data base may, in fact, be based on information concerning different people.

Table 11

Filing Units with Gains and Losses under the Comprehensive Income Tax as Compared to the Present Law Income Tax 1/

(1976 levels)

	Tax decrease			Tax increase		
	Number of filing units (millions)	Amount of tax change ($ billions)	Average decrease for filing units with decrease (dollars)	Number of filing units (millions)	Amount of tax change ($ billions)	Average increase for filing units with increase (dollars)
All filing units with gains and losses	60.9	23.0	378	37.2	24.1	648
Filing units with $500 or more of pension income	5.0	2.2	431	17.7	13.5	764
Filing units with less than $500 of pension income	55.9	20.9	373	19.5	10.6	543
Single filers	27.7	4.1	148	3.6	1.2	331
Age less than 22	13.7	0.6	46	1.0	0.1	107
Age 22 to 61	13.0	3.2	245	2.4	1.0	427
Age 62 or over	1.0	0.3	293	0.2	0.1	254
Joint filers	24.2	15.8	654	12.9	8.4	653
Earning status:						
One earner	10.2	6.7	657	8.6	5.2	608
Two or more earners	14.0	9.1	652	4.3	3.2	742
Dependency status:						
No dependents	6.9	5.1	745	4.4	2.9	643
Two dependents	5.8	3.5	607	2.8	1.7	624
Four dependents	1.7	1.1	649	0.7	0.5	747
Filing units with means-tested cash grant income	2.7	0.2	59	3.9	1.1	270

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1/ Filing units whose tax liabilities would change by more than 5 percent of present law tax or by more than $20.

Aside from such statistical details and the question of transition rules, comparisons of gainers and losers may be misleading on other grounds. The redistributions of income indicated may reflect not only changes in tax burdens among different taxpayers, but, perhaps more importantly, changes between the taxpayer at one point in his life and the same taxpayer at another point. For example, employee contributions to social security are excluded from taxable income, but social security benefits are included. As a result, the simulations show a decrease in tax for present wage earners and an increase in tax for pensioners.

Indeed, table 11 shows that almost half of those with tax increases are receiving $500 or more in pension income. This gives a misleading impression of the distributional consequences of the change, because present wage earners are future retirees. A more satisfactory comparison would be one that reflected the overall lifetime tax burden of different individuals under various plans. It has not been possible to perform simulations of such lifetime effects. Thus, the simulations that are shown tend to be biased toward a finding of greater redistribution than actually would be implied by the model plan.

THE CASH FLOW TAX

Table 12 shows, for each comprehensive income class, the derivation of gross consumption from comprehensive income. "Imputed consumption from owner-occupied housing" consists of the net rental value of owner-occupied dwellings, and is included in gross consumption even though a cash outlay may not be made for the rental services. "Corporate retained earnings" are deducted because they represent saving on behalf of households. Similar saving occurs in the form of earnings on life insurance policies, contributions to and earnings of private pension plans, and employee contributions to social security. "Direct saving" represents household net purchases of real and financial assets. In table 12, gross consumption is derived by subtracting the sum of all forms of saving from the sum of comprehensive income plus imputed consumption.

The term "gross consumption" is used because consumption is here considered to be gross of income taxes paid under current law; in other words, gross consumption represents before-tax consumption. Gross consumption is the starting point of the cash flow tax in the same way that comprehensive income is the starting point of the comprehensive income tax.

Table 12

Comprehensive Income and Gross Consumption

(1976 levels)

Comprehensive income class	Comprehensive income	Imputed consumption from owner-occupied housing	Saving: Corporate retained earnings	Saving: Saving in life insurance, pension plans, and social security	Saving: Direct saving	Gross consumption
($000)	(................................ $ billions					.................................)
Less than 0	-3.6	0.1	0.1	0.0	-5.9	2.3
0 - 5	81.0	1.3	0.3	0.4	3.0	78.6
5 - 10	171.2	3.6	0.9	2.1	8.1	163.7
10 - 15	205.7	7.0	1.1	3.3	14.0	194.4
15 - 20	209.1	8.3	1.3	4.0	18.3	193.8
20 - 30	253.7	9.7	2.4	5.6	26.7	228.7
30 - 50	169.0	4.9	3.5	3.2	18.9	148.3
50 - 100	120.2	2.1	4.0	1.3	16.8	100.2
100 or more	63.5	0.7	6.0	0.5	6.8	51.0
Total	1,269.9	37.8	19.6	20.5	106.7	1,160.9

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Note: Gross consumption equals comprehensive income plus imputed consumption from owner-occupied housing minus all of the following forms of savings: corporate retained earnings, saving in life insurance plans, social security contributions, and direct saving.

As was explained earlier in connection with the comprehensive income tax, taxpayers must be classified properly before the distribution of tax burdens can be analyzed. All tables dealing with the cash flow tax will use gross consumption for classification purposes.

Table 13 shows the derivation of the cash flow tax base. The provisions for child care and secondary workers are the same for the cash flow tax as for the comprehensive income tax. Exemptions under the cash flow tax are $1,500 per return and $800 per taxpayer and dependent. Adjusting gross consumption for the child care and secondary worker provisions and for exemptions yields the amount of cash flow subject to tax. A comparison of the amounts subject to tax in the two model plans, as shown in tables 8 and 13, indicates that the amount of cash flow subject to tax is about 7 percent less than the amount of comprehensive income subject to tax. Nonetheless, the amount of cash flow subject to tax is 23 percent more than present taxable income, as shown in table 8. Thus, even though saving is deducted, the model cash flow tax accomplishes a substantial broadening of the tax base.

The rate structure for joint returns under the cash flow tax would be as follows:

Income Bracket	Marginal Tax Rate
$ 0 - 5,200	10 percent
5,200 - 30,000	28 percent
Over 30,000	40 percent

For single returns, the rate structure would be as follows:

Income Bracket	Marginal Tax Rate
$ 0 - 3,200	10 percent
3,200 - 30,000	26 percent
Over 30,000	40 percent

Heads of households, as under present law, would pay the average of the amounts under the single and joint schedules.

Table 14 shows the distribution of tax liabilities and effective rates of tax under the model cash flow tax and present law. The model cash flow tax nearly reproduces the

Table 13

Cash Flow Tax Base

(1976 levels)

Gross consumption class	Number of filing units 1/	Gross consumption	Child care and secondary worker provisions	Exemptions 2/	Cash flow subject to tax
($000)	(... millions ...)	(............................	$ billions	....	...)
Less than 0	0.0	0.0	0.0	0.0	0.0
0 - 5	40.7	84.2	-0.1	-66.2	17.9
5 - 10	24.3	178.9	-1.8	-76.6	100.5
10 - 15	17.9	221.4	-5.7	-67.1	148.6
15 - 20	11.8	202.9	-7.3	-47.8	147.8
20 - 30	8.7	208.5	-6.8	-36.0	165.6
30 - 50	3.7	136.3	-2.6	-14.9	118.8
50 - 100	1.3	88.2	-0.8	-5.5	81.9
100 or more	0.3	40.6	-0.2	-1.1	39.2
Total	108.6	1,160.9	-25.3	-315.2	820.4

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1/ Includes all filing units whether or not they actually file returns or pay tax under current law.
2/ The amounts shown do not include the value of exemptions that, if allowed, would reduce cash flow subject to tax to below zero.

Table 14

Amount of Tax and Effective Tax Rates under the Present Law Income Tax and under Model Cash Flow Tax

(1976 levels)

Gross consumption class	Present law tax		Cash flow tax	
	Tax	Effective tax rate 1/	Tax	Effective tax rate 1/
($000)	(... $ billions ..)	(..... percent ...)	(... $ billions ..)	(..... percent ...)
Less than 0	0.0	0.0	0.0	0.0
0 - 5	1.8	2.2	1.8	2.1
5 - 10	13.2	7.4	13.7	7.7
10 - 15	26.2	11.8	26.3	11.9
15 - 20	30.0	14.8	30.6	15.1
20 - 30	37.5	18.0	38.2	18.3
30 - 50	32.2	23.6	31.4	23.1
50 - 100	27.1	30.7	26.8	30.3
100 or more	14.6	36.0	14.5	35.7
Total	182.6	15.7	183.3	15.8

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1/ Tax as a percentage of gross consumption.

progressivity of the present tax structure. It is clear that taxing consumption is perfectly consistent with a progressive structure of tax liabilities.

Although the model cash flow tax preserves the average progressivity of current law, it would extensively redistribute tax burdens. Table 15 tabulates filing units whose tax change would be more than 5 percent of present law tax or more than $20. This table yields essentially the same results as those presented in table 11 for the comprehensive income tax. The caveats in interpreting the results of table 11 apply with equal force to table 15.

COMPARISONS OF TAX LIABILITIES UNDER THE DIFFERENT PLANS

Up to this point, this chapter has presented simulations of the effects of the model tax plans on all taxpayers. This section examines the tax liabilities of taxpayers in particular situations. These materials illustrate the differences among the present law income tax and the two model plans. Since the data are hypothetical, they do not represent the situations for any particular taxpayer.

The Marriage Penalty

A subject of continuing controversy and interest is the division of the tax burden between married and unmarried individuals. Table 16 shows, for current law, the additional tax paid by a married couple filing a joint return over what would be paid if both persons could file single returns. The left-hand column shows the couple's total income. The subsequent columns present different shares of the total income earned by the lesser-earning spouse. For example, in the first column, one spouse earns all of the income. This column shows that a married couple would pay a lower tax than would a single individual with the same income because of the favorable rate structure of the joint return schedule. In the last column, earnings are derived equally from the wages of both spouses. In this case, the married couple would pay a higher tax than would two unmarried individuals, with a marriage penalty of $4,815 on a joint income of $100,000.

Table 17 shows the same data for the model comprehensive income tax plan. The area of marriage penalty has increased somwehat as compared to current law. However, the rate structure and exclusion of a portion of the earnings of

Table 15

Filing Units with Gains and Losses under the Cash Flow Tax Compared with Present Law Income Tax 1/

(1976 levels)

	Tax decrease			Tax increase		
	Number of filing units (millions)	Amount of tax change ($ billions)	Average decrease for filing units with decrease (dollars)	Number of filing units (millions)	Amount of tax change ($ billions)	Average increase for filing units with increase (dollars)
All filing units with gains and losses	53.6	31.0	577	44.7	31.7	708
Filing units with $500 or more of pension income	5.1	3.5	700	17.9	13.7	765
Filing units with less than $500 of pension income	48.6	27.4	564	26.8	18.0	671
Single filers	24.5	4.9	199	6.6	2.0	309
Age less than 22	12.6	0.5	43	2.0	0.3	130
Age 22 to 61	11.0	3.9	360	4.3	1.7	392
Age 62 or over	0.9	0.4	410	0.3	0.1	313
Joint filers	20.6	21.4	1,037	16.6	14.6	880
Earning status:						
One earner	8.9	9.6	1,075	10.0	8.8	876
Two or more earners	11.7	11.8	1,007	6.6	5.9	885
Dependency status:						
No dependents	6.8	8.0	1,174	4.6	4.1	889
Two dependents	4.6	4.3	933	4.0	3.5	884
Four dependents	1.3	1.3	1,060	1.1	1.0	924
Filing units with means-tested cash grant income	2.4	0.2	73	4.4	1.5	352

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1/ Filing units whose tax liabilities would change by more than 5 percent of present law tax or by more than $20.

Table 16

Marriage Penalties in 1976 Law

The Marriage Penalty is the Excess of the Tax a Couple Pays with a Joint Return Over What It Would Pay if Both Persons Could File Single Returns

Total family income	Dollar amount of marriage penalty when share of income earned by lesser-earning spouse is: None	10 percent	20 percent	30 percent	40 percent	50 percent
	(................................ No Marriage Penalty ....)					
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
3,000	-42	0	0	0	0	0
5,000	-233	-149	-69	12	87	130
7,000	-266	-137	-18	101	201	212
10,000	-383	-163	43	191	216	221
15,000	-527	-187	97	162	237	263
20,000	-762	-240	56	189	258	243
25,000	-1,085	-324	29	235	319	365
30,000	-1,406	-442	13	320	497	565
40,000	-2,013	-657	149	661	1,034	1,188
50,000	-2,697	-799	334	1,188	1,743	1,910
100,000	-6,810	-2,532	605	2,819	4,275	4,815
			(................ Marriage Penalty ....)			

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Note: In all tax calculations, deductible expenses are assumed to be 16 percent of income, and the maximum tax is not used.

Table 17

Marriage Penalties in the Model Comprehensive Income Tax

The Marriage Penalty is the Excess of the Tax a Couple Pays with a Joint Return Over What It Would Pay if Both Persons Could File Single Returns

Total family income	None	10 percent	20 percent	30 percent	40 percent	50 percent
	Dollar amount of marriage penalty when share of income earned by lesser-earning spouse is:					
	(.......... No Marriage Penalty ....)					
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
3,000	-32	-8	0	0	0	0
5,000	-80	-50	-20	10	40	62
7,000	-312	-169	-25	46	72	58
10,000	-441	-278	-116	15	97	122
15,000	-316	-72	140	263	300	206
20,000	-191	134	347	425	300	175
25,000	-66	340	555	456	300	300
30,000	59	515	675	488	425	425
40,000	309	847	800	675	675	675
50,000	244	1,477	1,432	1,432	1,432	1,432
100,000	244	1,835	3,385	4,935	6,485	6,888
	(.......... Marriage Penalty ....)					

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the secondary worker would result in some changes relative to current law. This may be seen most clearly in the last column. Although the marriage penalty paid by a couple earning $100,000 would increase, for all other families in which equal earners marry, the marriage penalty would be reduced compared to current law. As the first column shows, the differences between married couples and unmarried individuals are, in general, reduced in the model comprehensive income tax plan compared to current law. This is because the broader tax base permits a less steep progression of marginal tax rates. Table 18 shows the marriage penalties under the model cash flow tax.

Lifetime Comparisons

As suggested above, a desirable point of view from which to assess the relative tax burdens among individuals is that of the complete lifetime. The tables presented thus far do not reflect this lifetime perspective. If either of the model tax plans had been in effect as long as the present tax, the income and tax situations of taxpayers would be different from those shown in the simulated results.

This is particularly true of saving, which is subject to considerably different treatment under the model plans. For persons accumulating for their retirement years in savings accounts, the present law would collect tax on the income from which the saving is made and again on the interest earned on the savings. Withdrawal of funds, however, would have no tax consequence. Under the cash flow tax, savings would not be subject to tax; rather, taxes would be assessed when the proceeds are withdrawn for consumption. The comprehensive income tax would be levied both on income saved as well as on interest earned, but the broader base would permit lower rates than under present law.

Since one objective of saving is the reallocation of lifetime consumption, these three tax systems would be expected to alter the timing of income, consumption, and tax liabilities. Table 19 summarizes these effects. It shows summary statistics for a family whose saving strategy is to maintain a constant level of consumption throughout working and retirement years. This table provides a very direct and convenient way of comparing the different systems, since tax burdens may be determined directly from the level of consumption. The higher is the level of consumption attainable, the lower is the tax burden. In this example, the

Table 18

Marriage Penalties in the Model Cash Flow Tax

The Marriage Penalty is the Excess of the Tax a Couple Pays with a Joint Return Over What It Would Pay if Both Persons Could File Single Returns

Total family income	Dollar amount of marriage penalty when share of income earned by lesser-earning spouse is:					
	None	10 percent	20 percent	30 percent	40 percent	50 percent
	(.................................... No Marriage Penalty ....)					
$ 0	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
3,000	-70	-40	-10	0	0	0
5,000	-80	-42	-5	32	70	88
7,000	-320	-156	9	77	80	63
10,000	-494	-304	-114	6	96	106
15,000	-394	-109	106	241	296	191
20,000	-294	86	296	396	256	116
25,000	-194	261	486	391	216	216
30,000	-94	406	596	386	316	316
40,000	-144	886	1,244	1,044	1,044	1,044
50,000	-144	1,086	1,366	2,066	2,444	2,444
100,000	-144	1,366	2,766	4,166	4,488	4,488
		(.......................... Marriage Penalty ....)				

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Table 19

Lifetime Comparison of Present Law Income Tax and Model Tax Plans
(Married couple; one earner, wages $16,000 per year for 40 years;
consumes at maximum possible steady rate over entire lifetime)

	Present law tax	Comprehensive income tax	Cash flow tax
Consumption:			
All ages	$ 11,456	$ 11,524	$ 11,713
Savings account balance:			
Age 40	60,114	53,759	58,764
Age 60	151,185	137,651	164,900
Taxes:			
Working years:			
Age 21	2,102	2,318	2,100
Age 40	2,272	2,696	2,100
Age 60	2,582	3,312	2,100
Retirement years:			
Age 61	845	42	2,100
Age 75	505	0	2,100

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Note: This example assumes a 3-percent real rate of return (before taxes) on savings and that the corporation income tax under present law is borne by the return from all savings at the rate of 19.1 percent.

present law tax burden is somewhat higher (consumption is lower) than that implied by the model comprehensive income tax, which in turn is higher than that under the cash flow tax.

Chapter 6

TRANSITION CONSIDERATIONS

INTRODUCTION

Major changes in the tax code such as would accompany a switch to either the comprehensive income tax or the cash flow tax may lead to substantial and sudden changes in current wealth and future after-tax income flows for some individuals. Transition rules need to be designed to minimize unfair losses, or undeserved windfalls, to individuals whose investment decisions were influenced by the provisions of the existing code.

This chapter discusses the major issues in transition and suggests possible solutions to problems arising from transition to both the comprehensive income tax and the cash flow tax. It outlines the major wealth changes that can be expected under a switch to either of the two model taxes, and discusses the relevant equity criteria to be applied in the design of transition rules. Instruments for ameliorating transition problems, including phasing in provisions of the new law and grandfathering, or exempting, existing assets from the new rules are discussed. The effects of applying these transition instruments to different types of changes in the tax law are outlined. Transition rules to be applied to specific changes in the tax law included in the model comprehensive income tax in chapter 3 are considered. Special problems of transition to a cash flow tax are discussed also, and a plan is suggested for transition to the cash flow proposal described in chapter 4.

WEALTH CHANGES AND THEIR EQUITY ASPECTS

Two separate problems requiring special transition rules can be identified: carryover and price changes. Carryover problems would occur to the extent that changes in the tax code affect the taxation of income earned in the past but not yet subject to tax or, conversely, income taxed in the past that may be subject to a second tax. Price changes would occur in those instances where changes in the tax code altered the expected flow of after-tax income from existing investments <u>in the future</u>.

Carryover Problems

Under the present tax system, income is not always taxed at the time it accrues. For example, increases in net worth in the form of capital gains are not taxed before realization. A change in the tax rate on realized capital gains, therefore, would alter the tax liability on gains accrued but not realized before the effective date of the tax reform. Application of the new rules to past capital gains would either raise or lower the applicable tax on that portion of past income, depending on whether the increase in tax from including all capital gains in the income base exceeded the reduction in tax caused by any allowance of a basis adjustment for inflation.

The problem of changes in the timing of tax liability would be especially severe if the current tax system were changed to a consumption base. Under a consumption base, purchases of assets would be deductible from tax and sales of assets not reinvested would be fully taxable. Under the current tax system, both the income used to purchase assets and the capital gain are subject to tax, the latter, however, at a reduced rate. Recovery of the original investment is not taxed. An immediate change to a consumption base would penalize individuals who saved in the past and who are currently selling assets for consumption purposes. Having already paid a tax on the income used to purchase the asset under the old rules, they would also be required to pay an additional tax on the <u>entire</u> proceeds from the sale of the asset. On the other hand, if owners of assets were allowed to treat those assets as tax-prepaid, they would receive a gain to the extent they planned to use them for future consumption or bequest. Income on past accumulated wealth would then be free from future taxes, and the government would have to make up the difference by raising the tax rate on the remaining consumption regarded as non-pretaxed.

Other carryover problems include excess deductions or credits unused in previous years and similar special technical features of the tax law. In general, carryover can be viewed as being conceptually different from changes in the price of assets. In the case of capital gains tax, for example, the change in an individual's tax liability for gains that have arisen by reason of a past increase in asset values does not affect the tax liability of another individual purchasing an asset from him; in general, the asset price depends only on <u>future</u> net-of-tax earnings. However, the new tax law <u>and</u> the transition rules, by altering future net-of-tax earnings, would change the price of assets.

In most cases, carryover problems could be handled by special rules that define the amount of income attributable to increases in asset values not realized before the effective date of implementation of the new law. Changes in the definition of an individual's past income would alter asset prices only if they provided an incentive for pre-effective date sales of existing assets. For example, if, under the new system, past capital gains were taxed at a higher rate than under the old system, an incentive might be created for sales of assets prior to the effective date.

Price Changes

Adoption of a broadly based tax system would change prices of some assets by changing the taxation of future earnings. Under the comprehensive income tax, for example, the following changes in the tax code would alter tax rates on income from existing assets: integration of the corporate and personal income taxes; taxation of all realized capital gains at the full rate; adjustment of asset basis for inflation (or deflation); inclusion of interest on State and local government bonds in the tax base; elimination of accelerated depreciation provisions that lower the effective rate of tax on income arising in special sectors, including minerals extraction, real estate, and some agricultural activities; and elimination of the deductibility of property taxes by homeowners. Adoption of these and other changes in the tax code would alter both the average rate of taxation on income from all assets and the relative rates imposed among types of financial claims, legal entities, and investments in different industries.

The effects of changes in taxation on asset values would be different for changes in the average level of taxation of the associated returns and changes in the relative rates of taxation on different assets. A change in the average rate of taxation on all income from investment, while it would affect the future net return from wealth or accumulated past earnings, would not be likely in itself to change individual asset prices significantly. For any single asset, an increase in the average rate of taxation of returns would reduce net after-tax earnings roughly in proportion to the reduction in net after-tax earnings on alternative assets. Thus, the market value of the asset, which is equal to the ratio of returns net of depreciation to the interest rate (after tax), would not tend to change. On the other hand, an increase in the relative rate of taxation on any single asset generally would lead to a fall in the price of that asset, because net after-tax earnings would fall relative to the interest rate. The opposite holds for a decrease in the relative rate of taxation.

The behavior of the price of any single asset in response to a change in the relative rate of taxation of its return depends on the characteristics of the asset and the nature of the financial claim to it. For example, suppose the asset is a share in an apartment project. In the long run, the price of the asset will depend on the cost of building apartments; if unit construction costs are independent of volume, they will not be altered by changes in the tax rate on real estate profits.

Now, suppose the effective rate of taxation on profits from real estate is increased. The increase in tax will drive down the after-tax rents received by owners. Because the value of the asset to buyers depends on the stream of annual after-tax profits, the price a purchaser is willing to pay also will fall. With the price of the structure now lower than the cost of production, apartment construction will decline, making rental housing more scarce and driving up the before-tax rentals charged to tenants. In final equilibrium, the before-tax rentals will have risen sufficiently to restore after-tax profits to a level at which the price buyers are willing to offer for the asset is again equal to its cost of production. However, for the interim before supply changes restore equilibrium, after-tax returns would be lowered by the price change.

Thus, the immediate effect of the change in the rate of taxation would be to lower the price of equity claims to real estate. The wealth loss to owners of those shares at the time of the tax change would depend both on the time required for adjustment to final equilibrium and the extent to which future increases in the gross rentals (from the decline in housing supply) were anticipated in the marketplace. The faster the adjustment to equilibrium and the larger the percent of gross rentals change that is anticipated, the smaller the fall in asset price will be for any given increase in the tax on the returns.

If the asset is a claim to a fixed stream of future payments (e.g., a bond), a change in the rate of taxation would alter its price by lowering the present value of the future return flow. For example, if interest from municipal bonds became subject to tax, the net after-tax earnings of holders of municipal bonds would fall, lowering the value of those claims. New purchasers of municipal bonds would demand an after-tax rate of return on their investment comparable to the after-tax return on other assets of similar risk and liquidity. The proportional decline in value for a given tax change would be greater for bonds with a longer time to maturity.

The effect of corporate integration on the price of assets is less certain. If the corporate income tax is viewed as a tax on the earnings of corporate equity shareholders, integration would increase the rate of taxation on income from investment of high-bracket shareholders and lower the rate of taxation on such income of low-bracket shareholders. 1/ In addition, many assets owned by corporations also can be used in the noncorporate sector. To the extent that relative tax rates on income arising in the two sectors were altered by integration, those assets could easily move from one sector to the other, changing relative before-tax earnings and output prices in the two sectors, but keeping relative after-tax earnings and asset prices the same.

In conclusion, raising the relative rate of taxation on capital income in industries and for types of claims currently receiving relatively favorable tax treatment would likely cause some changes in asset prices. Immediate asset price changes generally would be greater for long-term fixed claims, such as State and local bonds, than for equity investments; greater for assets specific to a given industry (e.g., apartment buildings) than for assets that can be shifted among industries; and greater for assets the supply of which can only be altered slowly (e.g., buildings and some mineral investments) than for those the supply of which can be changed quickly.

The net effect of integration on asset values may not be large. On the other hand, changes in the special tax treatment currently afforded in certain industries, for example in real estate and mineral resources, and changes in the treatment of State and local bond interest, would likely cause significant changes in values of those assets.

The Equity Issues

Considerations of equity associated with changes in tax laws are different from equity considerations associated with the overall design of a tax system. Changes in the tax code would create potential inequities to the extent that individuals who made commitments in response to provisions of the existing law suffer unanticipated losses (or receive unanticipated gains) as a result of the change. These gains (and losses) can be of two types: (1) wealth changes to individuals resulting from changes in tax liabilities on income accrued in the past but not yet recognized for tax purposes, and (2) changes in the price of assets or the value of employment contracts brought about by changes in future after-tax earnings. These two types of problems, carryover and price change, pose somewhat different equity issues.

Carryover poses the problem of how to tax equitably income attributable to an earlier period, when a different set of tax laws was in effect. For example, consider one aspect of the proposed change in the tax treatment of corporations under the comprehensive income tax. At present, capital gains are subject to lower tax rates than dividends, especially when realization is deferred for a long period of time. Individuals owning shares of corporations paying high dividend rates relative to total earnings pay more tax than individuals owning shares of corporations with low dividends relative to total earnings. As both types of investment are available to everyone, individuals purchasing shares in high-dividend corporations presumably are receiving something (possibly less risk or more liquidity) in exchange for the higher tax liability they have to assume. To subject shareholders of low-dividend corporations to the same rate of taxation as they would have paid if income accumulated in the form of capital gains before the effective date had been distributed would be unfair.

Carryover poses another equity problem: some taxpayers may be assessed at unusually high or low rates on past income because of changes in the timing of accrual of tax liability. The above example can be used to illustrate this point too. Under current law, the special tax treatment of capital gains in part compensates shareholders for the extra tax on their income at the corporate level. Under the integration proposal presented in chapter 3, the separate corporate income tax would be eliminated, but shareholders would be required to pay a full tax on their attributed share of the corporation's income, whether or not distributed.

Now, suppose integration is introduced and a shareholder has to pay the full tax on the appreciation of his shares that occurred before the effective date. 2/ The taxpayer would, in effect, be taxed too heavily on that income, because it was subject to taxation at the corporate level before being taxed at the full individual income tax rate. Before integration, he would, in effect, have paid the corporate tax plus the reduced capital gains rate on the gains attributable to that income; after integration, he would be liable for the tax on ordinary income at the full rate. Thus, in the absence of transition rules, he would be subject to a higher tax on income in the form of capital gains accrued before, but not recognized until after, the effective date of the new law than on income earned in a similar way under a consistent application of either present law or the comprehensive income tax.

The most desirable solution to the problem of equity posed by carryover is to design a set of transition rules that insure that, to the maximum extent consistent with other objectives, tax liabilities on income accrued before the effective date are computed according to the old law and tax liabilities on income accrued after the effective date are computed according to the new law.

Changes in future after-tax income brought about by tax reform raise a different set of equity issues. A complete change in the tax system, if unexpected, would cause losses in asset value to investors in previously tax-favored sectors. Imposition of such losses may be viewed as unfair, especially since past government policy explicitly encouraged investment in those assets.

For example, as between individuals in a given tax bracket one of whom held State and local bonds producing a lower interest rate because such interest was tax-exempt and the other of whom held taxable Treasury bonds producing higher interest but the same after-tax return, it seems reasonable to compensate the holder of the State and local bonds for the loss suffered upon removal of the tax exemption so that he ends up in the same position as the holder of Treasury bonds. Note that this concept of distributive justice does not imply that a third taxpayer, who earns higher after-tax income from tax-free bonds than from Treasury bonds because he is in a higher tax bracket than the other two, should retain the privilege of earning tax-free interest. Equity does not require that the tax system maintain loopholes; it does require some limitation on wealth losses imposed on individuals because they took advantage of legal tax incentives.

The counterargument to the view that justice requires compensation for such wealth changes is that all changes in public policy alter the relative incomes of individuals and, frequently, asset values. For example, a government decision to reduce the defense budget will lower relative asset prices in defense companies and their principal supplying firms and also lower relative wages of individuals with skills specialized to defense activities (e.g., many engineers and physicists). Although some special adjustment assistance programs exist, 3/ it is not common practice to compensate individuals for changes in the value of physical and human assets caused by changes in government policies. In addition, it can be argued that, because investors in tax-favored industries know the tax subsidy may end, the risk of a public policy change is reflected in asset prices and rates of return. If, for example, it is believed that the continuing debate over ending remaining special tax treatment of oil industry assets poses a real threat, it can be argued that investors in oil are already receiving a risk premium in the form of higher than normal net after-tax returns, and further compensation for losses upon end of the subsidy is unwarranted.

The discussion above suggests that a case can be made both for and against compensation of individuals for losses in asset values caused by radical changes in tax policy. Because the asset value changes resulting from the tax change alone are virtually impossible to measure precisely, designing a method to determine the appropriate amount of compensation would be difficult on both theoretical and practical grounds. However, it would be desirable to design transition rules so that unanticipated losses and gains resulting from adoption of a comprehensive tax base would be moderated. Two possible design features, grandfathering existing assets and phasing in the new rules slowly, are discussed next.

INSTRUMENTS FOR AMELIORATING TRANSITION PROBLEMS

Objectives

The main criteria that transition rules should satisfy are: (1) simplicity, (2) minimizing incentive problems, and (3) minimizing undesirable wealth effects.

Simplicity. The transition rules in themselves should not introduce any major new complexity in the tax law. To the extent possible, transition rules should not require that corporations or individuals supply additional data on financial transactions or asset values.

Minimizing Incentive Problems. The transition rules should be designed to minimize the probability of action in response to special features of the change from one set of tax rules to another. In particular, there should not be special inducements either to buy or to sell particular kinds of assets just before or after the effective date of the new law.

Minimizing Undesirable Wealth Effects. Transition rules should moderate wealth losses to individuals holding assets that lose their tax advantages under basic tax reform as well as gains to those whose assets are relatively favored. At the same time, special transition rules to protect assetholders from loss should not give them the opportunity to earn windfall gains.

Alternatives

Two alternative methods of reducing capital value changes are discussed here: grandfathering existing assets and phasing in the new law.

Grandfathering. The grandfather clause was originally used by some southern States as a method for disenfranchising black voters following the Civil War. It exempted from the high literacy and property qualifications only those voters or their lineal descendants who had voted before 1867. More recently, grandfather clauses have been used to exempt present holders of positions from new laws applicable to those positions, e.g., setting a mandatory age of retirement. In the context of tax reform, a grandfather clause could be used either to exempt existing assets from the new law as long as they are held by the current owner or to exempt existing assets from the new law regardless of who holds them. A grandfather clause also could be applied to capital gains accrued but not yet realized at the time the new law went into effect.

Consider, for example, the effect of eliminating the special depreciation rules that result in a low rate of taxation on income from real estate investments. A grandfather clause that exempts existing buildings only so long as they are held by the current owner(s) would mean that current owners could depreciate their buildings to zero according to the old rules, but that new owners could not do so. Grandfathering the buildings independently of their owners would allow subsequent purchasers to depreciate according to the old rules. 4/ This would have the effect of raising the value of the buildings. Elimination of tax incentives in real estate would discourage new construction, reducing the supply of housing and raising gross rentals before tax. Thus, grandfathering, by making existing property more valuable, would give a windfall gain to investors in real estate tax shelters. On the other hand, grandfathering the buildings only for current owners would not prevent a wealth loss to real estate investors, because the value to new buyers would decline. The loss would be mitigated by the anticipated increase in after-tax profits to current investors (because of the decline in housing supply).

The effect of grandfathering on asset prices for fixed-interest securities is less certain. For example, if existing municipal bonds were grandfathered, annual interest received net of tax would be unchanged. However, the value of the tax saving from owning municipal bonds would change for two reasons. First, there would be no new tax-exempt municipal bond issues under the new rules; with fewer available tax-exempt bonds, the price of tax-exempt securities will rise, as will the marginal tax bracket at which such securities offer a net advantage. Second, the other changes in the tax system which would enable marginal tax rates in the highest brackets to fall, would reduce the gain from tax exemptions, driving down the demand for, and the price of tax-exempt securities. As demand and supply will both fall, it is not clear in what direction the price of the grandfathered securities would change, though the price change would be smaller than if the new rules were adopted immediately for all tax-exempt securities.

One problem of grandfathering is that it can provide an unanticipated gain to current owners of assets subject to favorable tax treatment. These owners would receive a gain because the new tax law would reduce the supply of previously favored assets, thus raising before-tax profits.

Grandfathering probably should be limited to cases where gross returns are not likely to be altered significantly by the change in taxation. For example, changes in the tax treatment of pensions would not be likely to affect before-tax labor compensation significantly, assuming the supply of labor to the economy is relatively fixed. While grandfathering tax treatment of pensions in current employment contracts would not be likely to raise significantly the value of those contracts relative to their value under the old law, an immediate shift to the new law would reduce the value of previously negotiated pension rights.

Phasing In. An alternative method of avoiding drastic changes in asset values is to introduce the new rules gradually. For example, taxation of interest on currently tax-exempt State and local bonds could be introduced slowly by including an additional 10 percent of interest in the tax base every year for 10 years. Phasing in the new rules would not alter the direction of asset value changes, but it would reduce their magnitude by delaying tax liability changes.

Assuming that the market incentives under the new law are preferable to the incentives under the current law, phasing in poses distinct disadvantages. Phasing in would delay application of the new rules, thus reducing the present value of the economic changes that would be encouraged and which are an important objective of the new rules. Phasing in also may introduce substantial complexity. The length of the phase-in period would depend on the desired balance of the gains in efficiency and simplicity from changing the tax system against the distributive inequities resulting from imposition of asset value changes on some investors.

Combination of Phasing In and Grandfathering. A possible variant on the two approaches outlined above is to adopt the new rules immediately for new assets while phasing in the new rules for existing assets. In many cases, grandfathering existing assets when new assets would be taxed more heavily under the new tax law would raise the market price of the old assets. By phasing in the new rules for the old assets, it would be possible to moderate the increase in present value of future tax liabilities, while at the same time reduced supply of new assets would raise before-tax returns on both new and existing assets. The two effects may roughly cancel out, leaving asset prices almost the same throughout the early transition period. For example, a gradual introduction of new, and more appropriate, depreciation schedules for existing residential real estate, 5/ with a concurrent adoption of the new rules for new buildings, would have the same incentive effects on new building as immediate adoption of the new law. Before-tax rentals on existing real estate would rise gradually, as supply growth is reduced, while tax liabilities on existing real estate also would rise. It is likely that, for an appropriate phase-in period, the asset value change to existing owners would be small. However, tax shelters on new construction would be totally eliminated immediately.

PROPOSED SOLUTIONS TO SELECTED PROBLEMS IN THE TRANSITION TO THE COMPREHENSIVE INCOME TAX

Adoption of the comprehensive income tax would have significant impact on the taxation of capital gains, corporate income, business and investment income, and personal income. The following discussion examines the problems that these changes present for transition. In most cases, possible solutions to these problems are suggested.

Capital Gains

Under the comprehensive income tax, no distinction will be made between capital gains and ordinary income, and losses will be fully deductible against income from other sources. The transition mechanism proposed is to allow capital gains (or losses) that have accrued as of the general effective date of the proposal to continue to qualify for capital gains treatment upon a sale or other taxable disposition for 10 years following such date. This "capital gain account" inherent in each asset could be determined in either of two ways:

1. By actual valuation on the general effective date of enactment of the proposal (or on an elective alternative valuation date to avoid temporary distortions in market value), or

2. By regarding the gain (or loss) recognized on a sale or exchange of the asset as having accrued ratably over the period the seller held the asset. The portion of the gain (or loss) thus regarded as having accrued prior to the effective date would be taxed at capital gain rates (or be subject to the limitation on capital losses) provided that the asset continued to meet the current requirements for such treatment. Recognition of capital gain (or loss) on the asset after the effective date would extinguish the capital gain (or loss) potential of the asset. Thus, gains on sale or exchange of an asset purchased after the effective date would not receive any special tax treatment.

Both of these systems have been employed in the Tax Reform Act of 1976 in connection with the so-called carry-over basis provisions at death -- the former for securities traded on established markets, and the latter for all other assets.

A number of technical rules relating to transfers and subsequent adjustments to basis would have to be provided. In general, the account should carry over to the transferee in certain tax-free transfers that reflect a change in the transferor's form of ownership of, or interest in, the asset, such as contributions to a controlled corporation (under section 351) or partnership (section 721) or a complete liquidation of certain controlled subsidiaries (section 332). In the case of a transfer of an asset to a controlled corporation or partnership, it may be appropriate to allow the shareholder or partner to elect to transfer the capital gain account of the asset to his stock or partnership interest, and have the asset lose its capital gain character in the hands of the corporation or partnership. Also, in the case of a sale or exchange where the seller is allowed nonrecognition of gain on the transaction because he acquires an asset similar to the asset disposed of, the capital gain account should attach to the newly acquired asset. For example, if a taxpayer is to be allowed nonrecognition treatment on the sale of a personal residence where another residence is acquired within a specified time, the capital gain account would attach to the new residence.

Rules also would be needed to take into account an increase or decrease in the basis of the property after the effective date. An increase in the basis of the property generally should not decrease the capital gain account, since the increase in basis generally will be accompanied by an increase in the fair market value of the asset (for example, where a shareholder contributes cash to a corporation); the increased fair market value due to the increase in basis would, when recognized, represent a return of the investment increasing the basis. On the other hand, a decrease in basis resulting from a deduction against ordinary income should reduce the capital gain account (i.e., code sections 1245, 1250, and other recapture provisions currently in the code that prevent the conversion of ordinary income into capital gain because of excess depreciation deductions or other means should continue to apply). In general, if the taxpayer's basis in an asset is required to be allocated among several assets (such as is required with respect to a nontaxable stock dividend) the capital gain account should be allocated in a similar manner.

Special rules also would be needed for section 1231 property, since net gains from the sale of such assets qualify for capital gains treatment. 6/ A workable rule would be to apply section 1231 to assets that qualify as section 1231 assets in the hands of the taxpayer on the general effective date, and continue to so qualify as of the date of sale or other taxable disposition. Such property would have a "section 1231 account" similar to the capital gain account attaching to each asset. Similar rules relating to transfers, basis adjustments, etc., also would apply.

Since an asset may be held for an indefinite period, a cutoff date for capital gains treatment is needed; otherwise, the complexity of the capital gains provisions in the code would continue for at least a generation. (Under the proposal, donors and decedents would be required to recognize gain or loss on the assets transferred, subject to certain exceptions and, thus, the capital gain account would not carry over to a donee or heir.) Accordingly, at the end of a specified period (say, 10 years), the capital gains deduction and the alternative tax treatment would expire. Admittedly, some of the equity problems resulting from immediate repeal of the capital gains provisions would remain even if complete repeal were delayed 10 years. The 10-year phase-out period, however, would allow gradual market adjustments and help protect the interests of investors who purchased assets in reliance on the current capital gains provisions.

An alternative to the capital gain account (and section 1231 account) procedure would be to phase out the deduction for capital gains (and the alternative tax) ratably over a specified number of years. For example, the 50-percent deduction for capital gains could be reduced five percentage points a year, so that at the end of 10 years the deduction would be eliminated. The simplicity of this alternative is the best argument for its adoption, since no valuation as of a particular date would be required.

Corporate Integration

Under the comprehensive income tax, corporations would not be subject to tax. Instead, shareholders would be taxable on their *prorata* share of corporate income, or would be allowed to deduct their *prorata* share of corporate loss. (See the discussion in chapter 3.)

The most significant transitional problems involve the question of timing and the treatment of income, deductions, credits, and accumulated earnings and profits that are earned or accrued before the effective date of the change-over to integration but that would be taken into account for tax purposes after such date. Other transition problems related to the foreign area are discussed in chapter 3.

Pre-effective Date Retained Earnings. Perhaps the most difficult transition problem posed by corporate integration is the treatment of corporate earnings and profits that are undistributed as of the effective date of integration. Such earnings would have been taxed to the shareholders as dividends if distributed before the effective date, or taxed at capital gains rates if recognized by means of sale or exchange of the stock. Under corporate integration, distributions made by a corporation to its shareholders would be tax-free to the extent of the shareholder's basis; distributions in excess of the shareholder's basis in his stock would be taxable. However, corporate earnings and profits accumulated before the effective date but distributed afterward should not be accorded tax-free treatment; to do so would discriminate against corporations that distributed (rather than accumulated) their earnings and profits in pre-integration taxable years. (In the case of shareholders who are content to leave the accumulated earnings and profits in corporate solution, however, the effect of corporate integration on the income generated by such accumulated earnings may give the same result as if such earnings had been distributed tax-free, since such income would be taxed directly to the shareholders, without the interposition of corporate tax, and would then be available to the shareholders as a tax-free dividend.)

The problem of accumulated earnings can be addressed by continuing to apply current law to corporate distributions that are made within 10 years after the effective date of integration and that (1) are made to persons who held the shares on such effective date with respect to which the distribution is made, and (2) are made out of earnings and profits accumulated before such date. Thus, a distribution to such shareholders out of earnings and profits accumulated by the corporation before the first taxable year to which corporate integration applies would be a dividend, taxable as ordinary income, unless the distribution would qualify for different treatment under current law. For example, a distribution received pursuant to a redemption of stock that is not essentially equivalent to a dividend under current law would continue to be treated as a distribution in part or full payment in exchange for the stock. On the other hand, an attempt to bail out the pre-effective date earnings and profits by means of a partial redemption of stock that would be treated as a dividend distribution under current law would continue to be so treated. The provisions of current law relating to electing small business (subchapter S) corporations would be helpful as a model in drafting this particular transition proposal. For purposes of determining how much of a distribution that is treated as a sale or exchange under current law would qualify for special capital gains treatment, the transition rules outlined above for changes in taxation of capital gains would apply.

In general, distributions with respect to stock acquired in a taxable transaction after the effective date would be subject to the new rules, and would reduce basis and not constitute income (unless such distributions exceeded the shareholder's basis). However, in those cases where the transferee acquired the stock after the effective date without recognition of gain by the transferor, current law would continue to apply to distributions from pre-effective date accumulated earnings and profits.

Distributions after the effective date would be deemed to be made first from the shareholder's distributable share of the corporation's post-effective date income and then from pre-effective date earnings and profits (similar to the subchapter S rules). Distributions in excess of these amounts would be applied against and reduce the shareholder's basis in his stock. Amounts in excess of the shareholder's basis generally would be considered income.

In order to avoid indefinite retention of such a dual system of taxation, the special treatment of pre-effective date earnings and profits would cease after a specified number of years following the effective date of integration. Distributions received after such date, regardless of source, first would be applied against basis and would be income to the shareholder to the extent they exceed basis. As previously indicated, pre-integration accumulated earnings and profits remaining after this date will not escape taxation completely at the shareholder level, since such earnings will be reflected in the gain recognized on a subsequent taxable transfer of the stock (such as a sale or a transfer by gift or at death), or may be taxed as a distribution in excess of basis. Before fixing the cutoff date for this provision, an effort should be made to determine quantitatively the extent of the benefit to the shareholders of the deferral of such taxation.

An alternative proposal was considered in an attempt to preserve the ordinary income character of distributions from pre-effective date earnings. This proposal would treat a shareholder as receiving a "deemed dividend" (spread ratably over a 10-year or longer period) in an amount equal to the lesser of the excess of the fair market value of the share of stock as of the effective date over its adjusted basis, or the share's prorata portion of undistributed earnings and profits as of such date. This proposal was rejected because of its complexity and because of the likelihood of substantial liquidity problems for certain shareholders.

Carryovers and Carrybacks. The carryover or carryback of items of income, deduction, and credit between taxable years to which the corporate income tax applies, and taxable years to which it does not, must be considered for purposes of the transition rules. To the extent practicable, an attempt should be made to treat such items in a manner that reflects the impact of the corporate income tax as in effect when such items were earned or incurred. In following this approach, however, no attempt should be made to depart from the general rules requiring that an item of income or loss be recognized before it is taken into account in computing gross income. Accordingly, unrecognized appreciation or decline in value of corporate assets (or stock of the corporation) attributable to the pre-effective date period should not be "triggered" or recognized solely because of the shift to full integration.

In general, certain deductions and credits may carry back to a preceding taxable year or carry over to a subsequent taxable year because of a limitation on the amount of such deduction or credit that the taxpayer may claim for the taxable year in which the deduction is incurred or the credit earned. Thus, for example, a net operating loss carryback or carryover arises because the taxpayer's deductions exceed his gross income. Capital loss deductions are limited to capital gains, deductions for charitable contributions are limited to a certain percentage of income, and the investment tax credit is limited to a percentage of the tax due. Also, the recapture as ordinary income, after the effective date, of deductions allowed and other amounts of income upon which tax has previously been deferred in pre-effective date years, has the effect of shifting that income to post-effective date years.

If income sheltered by a deduction (or income that would have been sheltered had the deduction been utilized in an earlier year) had been distributed as a taxable dividend, the net after-tax effect on the shareholder of the deferral or acceleration of a deduction would depend on his marginal tax bracket. In general, if the shareholder is in a lower bracket, he may realize more total after-tax income if the deduction is utilized in a pre-effective date year in which the corporate tax applies and in which the tax savings at the corporate level are distributed as a dividend. If the taxpayer is in a higher bracket, he may realize more total after-tax income if the deduction is utilized in computing his distributable share of taxable income after integration. To best approximate the net result that would occur if such items could be used in the year incurred or earned, unused deductions and credits incurred or earned in pre-effective date years should be given an unlimited carryback to earlier years of the corporation. In many cases this would benefit the taxpayer because he would receive a tax refund from such carryback earlier than he would under current law. Such benefits could be avoided to a large extent by charging the taxpayer an appropriate amount of interest for advancement of the refund

Deductions that could not be absorbed in pre-effective date years would be allowed to be carried in full to post-effective date years, subject to the limits established on the number of succeeding taxable years to which the item may be carried. In general, however, deductions carried over from a pre-effective date year should not flow through to the shareholders, either directly or indirectly, for use in offsetting the shareholder's income from other sources, but should be available only as deductions at the corporate level in order to determine the shareholder's prorata share of corporate income. This would avoid retroactive integration with respect to such deductions, since the deduction would not flow through when incurred; it also would avoid possible abuses by means of trafficking in loss corporations. Ordinary income upon which tax was deferred in pre-effective years should continue to be subject to recapture as ordinary income.

Generally, the carryover to a post-integration year of a tax credit earned in a pre-effective date taxable year would result in a windfall for the shareholder. If the credit had been used to offset corporate income tax in the year in which it was earned, the amount representing the tax at the corporate level offset by the credit would have been taxable to the shareholder, either when distributed as a dividend or when realized by means of sale of the stock. Accordingly, a rule should be devised by which the tax benefit of a credit carryover approximates the benefit that would result if the amount of the credit first offset a hypothetical corporate tax and then was distributed to the shareholder as a taxable dividend (or, perhaps, realized as capital gain).

In general, no losses incurred or available credits earned in post-effective date years would carry back to pre-effective date years, since such items would flow through to the shareholders after the effective date of integration.

Under present law, certain taxpayers, such as regulated investment companies, real estate investment trusts, and personal holding companies, receive a dividends-paid deduction for a taxable year even though the distribution is actually made in a subsequent year. Such distributions in post-effective date years should be allowed to relate back to the extent provided by current law for the purpose of determining the corporate tax liability for the appropriate pre-effective date year. The distribution would be considered to be out of pre-effective date earnings and profits (whether or not it exceeds the amount in such account) and taxable to the shareholders as a dividend from that source.

Rules will have to be provided to insure that, if an investment tax credit earned by a corporation in a pre-effective date taxable year is subject to recapture because of an early disposition of the property, the credit also is recaptured, either from the corporation or the shareholders. This could be accomplished at the corporate level by imposing an excise tax on the transfer or other recapture event in an amount equal to the appropriate income tax recapture.

Flow-Through of Corporate Capital Gains. During the phase-out period for capital gains, the net capital gain or net capital loss for taxable years after the effective date of corporate integration should be computed at the corporate level with respect to sales or exchanges of capital assets or section 1231 property by the corporation. The character of such net capital gain or net capital loss should flow through to the shareholders.

Flow-Through of Tax-Exempt Interest. If the character of capital gains is to flow through to shareholders, consistency would require that the character of any remaining tax-exempt interest received or accrued by a corporation after the effective date of corporate integration from any State or municipal bonds that are grandfathered also should flow through as tax-exempt interest to the shareholders. The tax-free character of the interest to shareholders would be preserved by increasing reducing the shareholder's basis by the amount of the interest attributable to him, but not including such interest in taxable income. Distribution would be treated as under the new law -- as a reduction of basis, but not included in income. Thus, such interest, if distributed, would leave both taxable income and basis unchanged.

Generally, under present law, State and municipal bond interest is received tax-free by the corporation, but is taxable as a dividend when distributed to shareholders. The 1976 Tax Reform Act, however, provides that, in certain cases, the character of tax-exempt interest distributed by a regulated investment company flow through as tax-exempt interest to its shareholders. 7/ If it is determined that the tax-exempt character of State and municipal bond interest received by all corporations should not flow through to shareholders, an exception should be made for regulated investment companies that have relied on the flow-through provisions of the 1976 Tax Reform Act.

Unique Corporate Taxpayers. The provisions of the tax code relating to taxation of insurance companies and other unique corporate taxpayers will have to be examined to determine what adjustments, if any, are required to take into account the effect of corporate integration on the special rules applying to such taxpayers. The determination of appropriate transition rules will depend on the nature of any changes made to the basic provisions.

Business and Investment Income, Individual and Corporate

In general, the repeal of code provisions that provide an incentive for certain business-related expenditures or investments in specific assets should be developed to minimize the losses to persons who made such expenditures or investments prior to the effective date of the new law. The principal technique to effectuate this policy would be to grandfather actions taken under current law. For example, any repeal of a tax credit (such as the investment tax credit) and any requirement that an expenditure that is currently deductible (such as soil and water conservation expenditures) must be capitalized should be prospective only. 8/ Subject to the rules prescribed above for corporations, unused tax credits earned in pre-effective date years should be available as a carryover to taxable years after the effective date to the extent allowed under current law. The repeal of special provisions allowing accelerated amortization or depreciation of certain assets generally should apply only with respect to expenditures made or assets placed in service after a specific cutoff date. The revised general depreciation and depletion rules should apply to property placed in service or expenditures made after an effective date. Thus, for example, buildings would continue to be depreciable in the manner prescribed by current law only in the hands of their current owners. A taxpayer who acquires a building and places it in service after the effective date would be subject to the new rules. Although this could result in losses in asset value for the current owners, grandfathering the asset itself could, particularly in the case of buildings, delay the effect of the new rules for an unacceptable period.

The deduction for local property taxes on personal residences should be phased out by allowing deduction of a declining percentage of such taxes.

The exclusion from gross income of interest on State and municipal bonds and certain earnings on life insurance policies should continue to apply to such interest and earnings on bonds and insurance policies that are outstanding as of the effective date.

When adoption of the comprehensive income tax results in ending those provisions of current law that allow the nonrecognition of gain (or loss) on sales or exchanges of particular assets, such changes should be effective immediately, with no grandfather clause. It is unlikely that the original decision to invest in such assets depended on an opportunity to make a subsequent tax-free change in investment. An exception may be appropriate, however, with respect to a repeal of the provision that excludes from gross income the value of a building constructed by a lessee that becomes the property of the lessor upon a termination of the lease. A grandfather clause should apply current law to the termination of a lease entered into before the effective date.

The proposal would allow an adjustment to the basis of an asset to prevent the taxation of "gain" that is attributable to inflation and that does not reflect an increase in real value of the asset sold by the taxpayer. The inflation adjustment should be applied with respect to inflation occurring in taxable years after the effective date. Making such an adjustment retroactive would result in a substantial unanticipated gain for many asset holders.

Other Individual Income

Under the comprehensive income tax, several kinds of compensation and other items previously excluded would be included in gross income, and deductions for a number of expenditures that can be considered personal in nature would be disallowed.

<u>Employee Compensation</u>. Such items as earnings on pension plan reserves allocable to the employee, certain health and life insurance premiums paid by the employer, certain disability benefits, unemployment benefits, and subsidized compensation would be included in gross income.

It may be presumed that existing employment contracts were negotiated on the basis that such items (other than unemployment compensation) would be excluded from the employee's gross income, particularly in those cases where the exclusion reflects a policy of encouraging that particular type of compensation. In the absence of special transition rules, the inclusion of such items in income could create cash flow problems or other hardships for employees under such contracts. For example, a worker who is required to include in income the amount of his employer's health insurance plan contribution may have to pay the tax on this amount from what was previously "take home" pay if he cannot renegotiate his contract.

This problem can best be solved by an effective date provision that would apply the new rules to compensation paid in taxable years beginning after a period of time to allow employers and employees to adjust to the new rules. Thus, the tax-free status of items paid by employers on the date of enactment would continue for a specified period, such as 3 years. Alternatively, the inclusion of these items of income could be phased in over such a period, including one-third after 1 year, two-thirds after 2 years, and the full amount after the third year. Special rules for military personnel could be devised to grandfather servicemen through their current enlistment or term of service. Earnings of a qualified pension plan allocable to the employee that are attributable to periods before this delayed effective date would not be included in the gross income of the employee. However, earnings attributable to periods after that date (as extended with respect to binding contracts) would be included in gross income as accrued.

Generally, unemployment compensation, which would be included in taxable income under the proposal, would not represent a return of a tax-paid basis to the recipient, since the "premiums," or employer contributions, with respect to such compensation were not included in his gross income. Thus, the full amount of such compensation should be included in taxable income immediately after the general effective date.

Medical and Casualty Loss Deductions. Under the comprehensive income tax, certain nonbusiness expenditures, such as casualty losses, and medical and dental expenses, would cease being deductible. Generally, the repeal of the deductibility of these expenses could be effective immediately. If the medical expense deduction is replaced by a catastrophic insurance program, or some other program to achieve the same ends, repeal of the deduction should coincide with the effective date of the substitute program.

Charitable Deductions. This provision should be phased in if the deductibility of charitable contributions is eliminated under the model comprehensive income tax. To the extent that direct public subsidies to the affected institutions do not replace the loss in private gifts from removal of the tax incentive for contributions, both employment in and services to beneficiaries of such institutions would decline greatly. A gradual phase-in would increase the extent to which employment losses occur through gradual attrition rather than layoffs and would aid in identifying the types of charitable recipients who might require greater direct public assistance when the deduction is completely ended. One possible method of phase-in would be to allow a declining fraction of contribution to be deductible in the first few years of the effective date.

Other Items Previously Excluded. The inclusion in gross income of scholarships, fellowships, and means-tested cash and in-kind government grants would not appear to present any transition problems because, generally, the amounts of these items were not bargained for by the recipient and do not represent a return of a tax-paid basis.

Treatment of Retirement Benefits. Under the comprehensive income tax, retirement benefits, including social security benefits and private pensions, will be included in the tax base, while contributions to private pension funds and to social security by both employees and employers will be exempted from any concurrent tax liability. A significant transition problem arises from this feature of the comprehensive income tax. In the absence of special transition rules, currently retired persons would be required to pay tax on the return of private pension contributions that had already been taxed. While the link between contributions and benefits is not so direct for social security, it still would be unfair to include social security benefits in the taxable income of persons who have been retired as of the effective date, again, because these taxpayers have paid tax on the part of income represented by employee social security contributions throughout their working years. Thus, persons retired as of the effective date should not have to pay tax on private retirement benefits which represent a return of contribution or on social security benefits. On the other hand, benefits paid by qualified pension plans that allowed deductibility of post contributions, should remain fully taxable, as under present law.

More complex provisions are required for retirement income of taxpayers who are in the middle of their working years as of the effective date. Such taxpayers will have been taxed on the employee portion of retirement contributions up to the effective date, but not afterwards. Thus, it seems fair that they should pay tax on a fraction of the retirement benefits which represent return of contribution, the fraction bearing some relation to the portion of the contributions that were excluded from taxable income. The general rule proposed is to include in the tax base a fraction of retirement income that represents return of contribution to an employee-funded pension plan. The fraction would depend on age at the effective date, ranging from 0 for taxpayers age 60 or over to 1 for taxpayers age 20 or under. A table could be provided in the tax form relating date of birth to the fraction of such income that is taxable. A similar treatment is proposed for social security benefits.

<u>Treatment of Gifts and Transfers at Death as Recognition Events</u>. Under the proposal, gifts and transfers at death would be treated as recognition events. Thus, in general, the excess of the fair market value of the asset transferred over its adjusted basis in the hands of the donor or decedent would be included in the gross income of the donor or decedent.

The portion of such gains attributable to the period before the effective date of any such recognition rule should be exempted. Provisions for such an exemption were made in the Tax Reform Act of 1976 in connection with the carryover basis at death rule. The gains deemed to have accrued after the effective date would be taxable on transfer at the same rates applying to other sources of income.

TRANSITION TO A CASH FLOW TAX SYSTEM

This section presents a proposal for transition from the current system to the model cash flow tax proposed in chapter 4. The problems involved in a transition to the cash flow tax would be considerable, and all of the alternative methods considered have major shortcomings. Presentation of this proposal includes discussion of administrative difficulties and some possible distributive inequities, and an explanation of why certain alternative plans were rejected.

In summary, the proposed transition plan would maintain the present tax alongside the cash flow tax for 10 years before total conversion to the cash flow tax. During the transition period, individuals would compute their tax liability under both systems and would be required to pay the higher of the two taxes. The corporate income tax would be retained for the interim and would be discontinued immediately at the end of the 10-year period. At that time, unrealized capital gains earned prior to full adoption of the cash flow tax would be "flushed" out of the system through a recognition date, at which point they would be taxed at the current capital gains rates. Payment of taxes on past capital gains could be deferred, at a low interest charge, to prevent forced liquidation of small businesses.

The transition program outlined here would not fully realize the goals of transition presented below. It would, however, mitigate the redistribution of wealth that would result from immediate adoption of a cash flow tax and would simplify the tax system by eliminating, within a reasonable period of time, the need to keep the personal and business income tax records currently required.

Goals of Transition

The main objectives to be realized by the transition rules for the cash flow tax are: (1) prevention of immediate or long-term redistribution of economic welfare, and (2) simplicity and administrative ease. Although some changes in consumption opportunities would be inevitable in a tax change as major as the one proposed, the proper transition program should be able to minimize large redistributions among taxpayers in ability to consume immediately and in the future. In particular, this program should prevent heavy additional tax liabilities (in present-value terms) for any clearly identifiable group of taxpayers. For purposes of simplicity, transition rules should eliminate the present tax system and its recordkeeping requirements promptly and, to the extent possible, avoid measuring current accumulated wealth and any annual changes in individuals' total wealth positions in the transition period, as well as afterward. After transition, the principal records for tax purposes would consist only of cash flow transactions for business activities, net deposits and withdrawals in qualified accounts, the usual wage and salary data, and transfer payments.

Distribution Issues

Two distribution issues are important in a transition to the cash flow tax: (1) treatment of untaxed income before the effective date and (2) changes in the distribution of after-tax consumption.

Equitable treatment of income untaxed before the effective date would require that an individual who had unrealized capital gains at the time of adoption of the new system be treated in the same way as the individual who realized the capital gains before the effective date. The practical problems involved in achieving this goal influence the specifics of the transition proposal discussed below.

The treatment of past accumulated income that has been taxed poses a more difficult problem of equity. Because the cash flow tax is, in an important sense, equivalent to exempting income from capital from tax, as outlined in chapter 4, a higher tax rate on current wages not saved would be required to maintain the same tax revenue. Thus, the short-term effect of a cash flow tax would be a higher after-tax rate of return from ownership of monetary or physical assets regarded as tax prepaid and a lower after-tax wage rate. The distributive consequences of this change could be modified if some or all of accumulated wealth were to be treated as if already held in qualified accounts; i.e., subject to tax upon withdrawal for consumption.

If existing wealth were to be regarded as tax-prepaid under the new system, all future returns from such assets, as well as return of principal, would not be subject to tax. On the other hand, if existing wealth were to be regarded as receipts in the first year of the cash flow tax, an equally logical approach, consumption of principal would be taxed, though the present value of tax liability would not increase as assets earned accrued interest, as it would under an income tax.

Table 1 illustrates the tax treatment, under a comprehensive income tax and under the two alternative methods of transition to the cash flow tax, of consumption out of $100 of past accumulated assets for different times at which wealth is withdrawn for consumption. A tax rate of 50 percent is assumed, assessed on annual interest earnings in the case of an income tax.

Table 1

Potential Consumption Out of Accumulated Wealth Under Different Tax Rules

Initial Wealth = $100
Assets Accumulate at 10 Percent Per Year If Untaxed; 5 Percent Per Year If Taxed

Years After Effective Date	Income Tax	Cash Flow Tax; Asset Tax-Prepaid	Cash Flow Tax; Asset in Initial Receipts
0	$100	$100	$ 50
10	$163	$259	$130
20	$265	$673	$336

Under a comprehensive income tax, the asset could be withdrawn and consumed tax-free, but future accumulation would be taxed. 9/ Under the cash flow tax, with the asset defined as tax-prepaid, returns from the asset would be allowed to accumulate tax-free and could also be withdrawn and consumed tax-free. Under the cash flow tax, with the asset value initially included in the tax base, consumption from the asset would be taxed upon withdrawal, but the rate of accumulation of the asset would not be affected by the tax.

A transition to a cash flow tax with assets initially defined as tax prepaid would increase the welfare of owners of assets. The after-tax consumption of these taxpayers would increase under the new system unless they consumed all of their wealth within the first year after the effective date, in which case consumption would be unchanged. If assets were initially included in the tax base, however, the after-tax consumption of owners of assets would decrease if they chose to consume a large portion of their wealth in the early years after the effective date. Inclusion of assets in the base would increase after-tax consumption relative to an income tax for asset-holders who deferred consumption out of accumulated wealth for a long period. 10/

As Table 1 illustrates, how past wealth is viewed would make a big difference in the present value of tax liabilities.

Inclusion of accumulated assets in the tax base would be unfair to older persons who are about to consume out of accumulated wealth during the retirement period, if the income from which this wealth was accumulated had been subject to tax during their working years. On the other hand, tax-prepaid designation would greatly benefit all owners of monetary and physical assets by redistributing after-tax dollars from labor to capital. Although returns from assets would in effect be nontaxable under a fully operational cash flow tax, past accumulation of wealth would have occurred under a different tax system, where individuals did not anticipate a sharp rise in the after-tax return to capital. Thus, tax-prepaid treatment of capital assets for transition purposes may be viewed as inequitable.

The distribution problem caused by defining existing capital assets as prepaid would be reduced over time. The increased incentive to savings provided by the cash flow tax should raise the rate of capital formation, increasing the amount of investment and eventually lowering before-tax returns to capital and raising before-tax wages. However, in the first few years after transition, higher tax rates on current wages would not be matched by a corresponding increase in before-tax wages.

For certain types of assets, the appropriate rule for transition definition is clear. Under the present system, investments in owner-occupied houses and other consumer durables are treated very similarly to tax-prepaid investments, and they should be defined as prepaid assets for purposes of transition to a cash flow tax. The accrued value of employer-funded pension plans should be treated in the same manner as qualified accounts, because the contributions were exempt from tax under the old system and the receipts were fully taxable.

Designation of past accumulated assets as tax-prepaid assets would be the easier transition to administer. There would be no need to measure existing wealth. Tax-prepaid assets could be freely converted to qualified assets to enable the individual to average his tax base over time. An individual converting a tax-prepaid asset to a qualified asset would be able to take an immediate tax deduction, but would become liable for taxes upon withdrawal of principal and subsequent earnings from the qualified account. 11/ If assets were defined initially to be part of an individual's tax base, it would be necessary to valuate them on the effective date. Individuals would have an incentive to understate their initial wealth holdings. Assets not initially accounted for could be deposited in qualified accounts in subsequent years, enabling an individual to take a deduction against other receipts.

A Preliminary Transition Proposal

Considering the objectives of basic reform (equity, simplicity, efficiency), it seems best to define all assets initially in transition to the cash flow tax as prepaid assets. For a period of 10 years, the existing tax code would be maintained, with taxpayers filing returns for both tax systems and paying the higher of the two computed taxes. 12/ For most taxpayers, the cash flow tax would be higher. However, for persons with large amounts of income from assets relative to wages, the current tax would be probably higher.

The corporate income tax would be retained throughout the transition period. Theoretically, stockholders paying the cash flow tax should receive their corporate earnings gross of corporate tax during the interim period. However, without full corporate integration, whereby all earnings would be attributed to individual stockholders, it would be practically impossible to determine what part of a corporation's earnings should be attributed to individuals paying the consumption tax and what part, to individuals paying tax under the old law. It is likely that ownership of corporate shares would be concentrated among individuals who would be subject to the current tax during the interim period. For reasons of simplicity, therefore, the corporate tax would be retained for the transition period and would be eliminated immediately afterward.

All sales of corporate stock purchased before the beginning of the transition period by individuals paying under either tax base would be subject to a capital gains tax at the existing favorable rates. The reason for this provision is that capital gains which were accrued but not realized before the interim period should be taxed as if they were income realized at the effective date. 13/ This is not administratively attractive, so for 10 years all capital gains would be taxed on realization, whichever tax base the individual was using.

A recognition date would be required at the end of the transition period to account for all remaining untaxed capital gains. Under the cash flow tax, with assets defined as prepaid and no records of current and past corporate earnings and profits kept, it would be impossible to distinguish between distributions that were dividends out of current income and distributions that were return of accumulated capital. The dividends would not be subject to tax under the new law. Distributing past earnings would be a way of returning to the individual tax-free, the capital gains which had arisen prior to the adoption of the cash flow tax. To eliminate the need for permanent corporate records to capture this past income, it would be necessary to have a single day of recognition for past gains at the end of the transition period.

However, it would be possible to develop a method of allowing the final capital gains tax assessed on the recognition date to be paid over a long period at a low interest rate, to avoid forced liquidation of small firms with few owners.

The advantages of the transition proposal outlined here are the following:

1. It would enable all of the simplifying features of a cash flow tax to be in full operation after 10 years, including elimination of tax records required under the present code, but not under the cash flow tax.

2. It would allow consumption out of past accumulated earnings to be exactly the same as it would have been under the current tax during the first years after the effective date.

3. It would provide for appropriate and consistent taxation of income earned before the effective date.

4. By eliminating taxes on returns earned after the effective date from past accumulated assets only on a gradual basis, it would mitigate the redistribution of wealth to current asset owners that would occur after immediate full adoption the cash flow tax.

The major disadvantages of this transition program are that it would require a recognition date that would impose a large, one-time administrative cost on the system, and it would require some taxpayers to fill out two sets of tax forms for a period of 10 years, a temporary departure from the long-term goal of simplicity.

Alternative Transition Plans

One alternative plan would be to adopt the new tax system immediately, designating all assets as prepaid, without a recognition date to flush out past capital gains. Although this plan would be the simplest one, it would give too great an economic advantage to individuals with unrealized asset appreciation and would cause too large a transfer of future after-tax consumption to present asset owners.

Another transition plan would be to adopt the cash flow tax immediately and designate all assets as receipts in the first year. This would require valuating all wealth on the effective date and imposing a one-time wealth tax. Such an approach would be harsh on older persons planning to live off accumulated wealth in the early years after the effective date.

A complicated variation on tax-prepaid treatment of assets would be one under which, in exchange for the elimination of taxes on consumption of assets defined as tax-prepaid, an initial wealth tax related to an individual's personal circumstances would be imposed. For example, the initial tax could be based on age and wealth, with higher rates for persons with more wealth and lower rates for older persons. 14/ Although it might provide a transition program that approximates distributive neutrality, such a plan would be a significant departure from the goal of simplicity.

A third option would allow three types of assets: tax-prepaid, as defined above; qualified, as defined above; and a third type, which would treat assets as defined under the current system. In principle, it would be desirable for persons to be able to consume out of the third type of assets tax-free and to invest in prepaid and qualified assets only out of savings from current income. In effect, this plan would initiate cash flow taxation on current earnings only and would treat pre-effective date earnings exactly as they are treated under the current system, including the same treatment of post-effective date capital accumulation from pre-effective date wealth. This plan would be extremely difficult to administer. Not only would individuals have to keep books for three types of assets, but total annual wealth changes also would have to be computed, in order to arrive at a measure of annual consumption. (Valuation of unsold assets would not be a problem because even if too high a value were imputed, raising both measured wealth and saving, consumption would remain unchanged.) Treatment of corporate income under this system also would be complicated, because some investments in corporate stock would come from all three types of assets.

Under this transition alternative, assets of the third type would be subject to a transfer tax and converted to prepaid assets at death. Eventually, these assets would disappear from the system, and the complete cash flow tax would be in operation. Alternatively, all assets of the third type could be designated prepaid after a fixed number of years.

Although the three-asset plan has the advantage of treating owners of capital exactly as they would have been treated under the income tax, and would change the rules only for new wealth, 15/ its administrative complexity raises very severe problems.

Footnotes

1/ The exact change in the rate of taxation on income earned in corporations for different taxpayers will depend on the fraction of corporate income currently paid out in dividends, the current average holding period of assets before realizing capital gains, and the taxpayer's rate bracket. While the current corporate income tax does not distinguish among owners in different tax brackets, integration, which would attribute all corporate earnings to the separate owners, would tax all earnings from corporate capital at each owner's marginal tax rate.

2/ The taxpayer could avoid this problem by selling his shares before the effective date at the current lower capital gains rate and then buying them back. However, one other objective of transition rules, discussed in the next section, should be to avoid encouraging market transactions just prior to the effective date.

3/ For example, workers damaged by employment reductions in industries with increasing imports due to liberalized trade policies are eligible for trade adjustment assistance.

4/ Note that is is not clear just what is meant by an "existing asset" in this context. For example, a building is greatly affected by maintenance and improvement expenditures over time.

5/ Appropriate depreciation schedules are those that conform most closely to the actual rate of decline in asset values.

6/ Section 1231 property is generally certain property used in the taxpayer's trade or business. If gains exceed losses for a taxable year, the net gains from section 1231 property are taxed at capital gains rates; if losses from section 1231 property exceed gains, the net losses are treated as ordinary losses.

7/ In the case of a subchapter S corporation, the character of net capital gains flows through to the shareholder. The character of tax-exempt interest does not.

8/ Expenditures made pursuant to binding contracts entered into before the effective date also should be grandfathered.

9/ The income tax computation assumes that all returns to investment would be taxed as accrued at full rates. Thus, the annual percentage rate of after-tax interest under the income tax would be cut in half. Under the present law, taxation of capital gains is deferred until realization and then taxed at only one-half the regular rate. For example, if the asset is sold after 20 years, potential after-tax consumption would be $530, which is computed by multiplying the long-term capital gain of $573 by .75 (the taxpayer is assumed to be in the 50 percent bracket) and adding the return of basis. It should be noted, however, that, if the asset is corporate stock, profits are also subject to an annual corporate tax. Combining the effects of corporate and personal taxes, the income of the asset holders may be taxed under current law at either a higher or lower rate than the rate on wage and salary income, depending on assumptions about the incidence of taxes.

10/ For example, if the before-tax interest rate were 10 percent, wealth would quadruple in 15 years. With the 50-percent tax rate used in Table 1, wealth holders would be better off under the consumption tax, even if their assets were initially included in receipts if they deferred consumption out of wealth for at least 15 years, obtaining a deduction against receipts in the first year by placing the asset in a qualified account.

11/ A wealthy person could appear to "shelter" his current consumption by converting prepaid assets into qualified assets, deducting the deposits in qualified assets from current wage and other receipts. However, this practice would not reduce the present value of his tax base, because he would have to pay a tax on the principal and accumulated interest whenever the qualified asset was withdrawn for consumption.

12/ It is possible that only wealthy persons should be required to fill out a return for the current personal income tax. The main reason for retaining the current tax would be to tax returns from past accumulated wealth for an interim period of time to mitigate the inequitable distribution effects of a transition to tax-prepaid treatment of assets. It is likely that only people with significant amounts of wealth would have a higher liability under the current tax. The requirement to file two income tax returns might be limited to taxpayers reporting an adjusted gross income above a certain minimum level (for example, $20,000 or more) in any of several years before the effective date.

13/ Technically speaking, individuals paying the cash flow tax during the interim period should not have to pay capital gains tax between the first day of the interim period and the time as asset is sold. One way to avoid this would be to adjust the basis upward to conform to interest that would have been earned on a typical investment after the beginning of the interim period. By doing this, the present value of capital gains tax paid for assets growing at that interest rate would be the same as if the gain were realized on the effective date.

14/ Because the wealth of older persons might be subject to the accessions tax sooner, it might not be necessary for reasons of equity to tax it on the effective date.

15/ The three-asset plan can be viewed as a sophisticated form of "grandfathering."

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DEPARTMENT OF THE TREASURY
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Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. January 18, 1977

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 million, or thereabouts, to be issued January 27, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,500 million, or thereabouts, representing an additional amount of bills dated October 28, 1976, and to mature April 28, 1977 (CUSIP No. 912793 F8 4), originally issued in the amount of $3,501 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,600 million, or thereabouts, to be dated January 27, 1977 and to mature July 28, 1977 (CUSIP No. 912793 J3 1).

The bills will be issued for cash and in exchange for Treasury bills maturing January 27, 1977, outstanding in the amount of $6,110 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,378 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, January 24, 1977. 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 or at the Bureau of the Public Debt on January 27, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing January 27, 1977. 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, or from the Bureau of the Public Debt.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: J.C. Davenport
Extension 2951
January 18, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES TENTATIVE REVOCATION OF DUMPING FINDING ON TUNERS (OF THE TYPE USED IN CONSUMER ELECTRONIC PRODUCTS) FROM JAPAN

Under Secretary of the Treasury Jerry Thomas announced today a tentative determination under the Antidumping Act to revoke a finding of dumping in the case of tuners (of the type used in consumer electronic products) from Japan. Notice of this decision will appear in the Federal Register of January 19, 1977. A finding of dumping with respect to tuners from Japan was published in the Federal Register of December 12, 1970. The finding had previously been modified to exclude therefrom five Japanese companies.

The Federal Register notice of January 17, 1977 will state in part that all of the firms for which the finding has been modified, together with Alps Electric Co., Ltd., and Waller Japan K.K., accounted for approximately 96.4 percent of all the subject tuners sold to the United States during the years 1970 through 1975 and that only *de minimis* dumping duties have been assessed on shipments of tuners from Japanese firms as a whole during a two-year period since the finding of dumping. In addition, written assurances have been received from all of the firms indicated above that future sales of tuners to the United States will not be made at less than fair value.

Imports of tuners from Japan during calendar year 1975 were valued at roughly $4 million.

* * *

WS-1268

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

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FOR IMMEDIATE RELEASE January 18, 1977

TREASURY SECRETARY SIMON SENDS PRIVATE PHILANTHROPY PROPOSALS TO CONGRESS TO IMPROVE PUBLIC ACCOUNTABILITY AND PREVENT ABUSES

Secretary of the Treasury William E. Simon On January 14, 1977 sent proposals for legislation on private philanthropy to the Chairmen and ranking minority members of the Congressional tax committees.

The Treasury proposals are intended to assure public confidence and support of philanthropic institutions and thereby sustain the vital role of private philanthropy in our society. The proposals would increase the public accountability of philanthropic institutions and improve the Federal tax treatment of charitable contributions. In transmitting the proposals to the Congress, the Secretary stated:

> "I know that you share my concern for improving public accountability and prevention of abuse in private philanthropy through sound legislation and I respectfully urge consideration of the proposals at the earliest possible date."

The Treasury proposals were stimulated by recommendations of the well-known privately-established Filer Commission (The Commission on Private Philanthropy and Public Needs) which were submitted to the Congress and the Ford Administration in December 1975. The Treasury studied these recommendations as well as recommendations of other groups and individuals.

WS-1269

Also, in response to a Filer Commission recommendation, Secretary Simon announced on January 6 the appointment of the Treasury Advisory Committee on Private Philanthropy and Public Needs. The 25 members are concerned citizens with knowledge and interest in the vitality of the philanthropic sector. The Chairman is C. Douglas Dillon, former Treasury Secretary. The Advisory Committee met on January 6 to organize, and has not had the opportunity to examine the Treasury proposals. The Committee will however consider the proposals in its work with the next Administration.

A summary of the Treasury proposals and a technical explanation of each proposal are attached.

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Attachment

TREASURY PROPOSALS TO IMPROVE PRIVATE PHILANTHROPY

INTRODUCTION

Private philanthropy plays an important role in our society today, complementing the efforts of government to meet our social and individual needs. Private philanthropy is uniquely capable of responding quickly and flexibly to fill new needs as they arise and of experimenting with new and untested methods in meeting existing needs.

However, the lack of adequate accountability to the public and evidence of abuse has created a growing public concern about the effectiveness of philanthropic institutions. Government officials are accountable at the polls and businessmen are accountable in the marketplace, but philanthropic organizations face no such test of their efforts, and their accountability to State officials burdened with other responsibilities has often been criticized as inadequate. The result has been the gradual erosion of public confidence in some private philanthropic institutions and of the public's willingness to contribute money, time and effort to them. This erosion of confidence and support, when coupled with financial difficulties that these institutions have been facing in recent years as a result of spiraling inflation, could lead to a severe crisis for private philanthropy generally and threaten its important role in our society.

To avoid this crisis and to restore public confidence and support to these institutions, proposals have been made to increase their public accountability, to minimize abuses, and to improve the Federal tax treatment of charitable contributions. During the past year the Treasury Department has studied the proposals of the privately-established

Commission on Private Philanthropy and Public Needs (the Filer Commission), as well as proposals of other groups and commentators.

As a result of this study, the Treasury Department is recommending to the Congress that it consider the following legislative proposals at the earliest feasible date.

SUMMARY OF PROPOSALS

I. Improving the Philanthropic Process

A. Accountability

1. Annual Report to the Public

In general, every private foundation, every public charity* that makes grants, and every public charity or social welfare organization with annual gross receipts of at least $100,000 would be required to make available to the public an annual report on its finances, programs and priorities.

In addition, a business organization making annual charitable contributions of at least $100,000 would be required to make available to the public an annual report on its charitable giving programs.

2. Regulation of Interstate Solicitation

Interstate solicitation would be subject to Federal legislation that would be administered by the Treasury Department. Disclosure would have to be made with respect to certain financial information about the soliciting organization, particularly with respect to its fund-raising and administrative costs.

*For purposes of these proposals a public charity is a philanthropic organization (an organization exempt under section 501(c)(3)) that is not a private foundation.

B. Extending Private Foundation Restrictions to Public Charities

1. Self-Dealing

The prohibitions and excise taxes on self-dealing transactions with private foundations would be extended to public charities.* However, the Secretary of the Treasury would be provided with regulatory authority to provide exceptions to strict prohibitions for classes of transactions, provided that they meet an arms-length standard.

2. Minimum Payout

Public charities* and private operating foundations would be required to spend or distribute annually for charitable purposes at least 3-1/3 percent of their noncharitable assets.

3. Jeopardy Investments

The prohibitions and excise taxes on investments that jeopardize the carrying out of the exempt purposes of a private foundation would be extended to public charities.* In addition, the tax would be imposed on any public charity (or private foundation) that retained an investment after it knew or should have known that it had become a jeopardy investment.

4. Taxable Expenditures

The prohibitions and excise taxes on proscribed expenditures made by private foundations would be extended to public charities.* However, these provisions would not apply in the case of lobbying expenditures by public charities that elect under current law to be subject to certain limits on those expenditures. In addition, public

*Consideration should be given to exempting very small public charities from these four restrictions.

charities would not be required to obtain prior approval of the Internal Revenue Service for certain grants to individuals, as private foundations must do.

C. Enforcement Procedures

1. Alternative Sanctions

United States District Courts would be invested with equity powers sufficient to remedy any violation of the substantive rules concerning philanthropic organizations in such a way as to minimize any financial detriment to the organization and to preserve its assets for its philanthropic purposes.

2. Audit Tax

The rate of tax on the net investment income of private foundations would be no more than 2 percent.

If many of the restrictions on private foundations are extended to public charities, consideration should be given to repealing the tax altogether.

II. Changes Affecting the Charitable Deduction

A. Minimum Tax

The charitable income tax deduction would be deleted as a tax preference item for minimum tax purposes.

B. Contributions for Foreign Philanthropic Purposes

The charitable deduction for income, estate and gift tax purposes would be made uniform in that no deduction would be allowed unless the contribution was made to an organization which was subject to the laws of the United States and which had full control and discretion as to where the contribution was to be distributed or spent.

C. Profiting from the Charitable Deduction

The charitable income tax deduction would be reduced to the extent necessary to prevent a high-bracket taxpayer with greatly appreciated property from obtaining a financial gain by contributing such property (as opposed to selling it).

TECHNICAL EXPLANATION

I. Improving the Philanthropic Process

A. Accountability

1. Annual Reports

a. Present law

Under present law, the only philanthropic organizations required to file annual reports for public inspection are private foundations having at least $5,000 worth of assets. The only source of information regarding a public charity available for public inspection is its annual return, and that lacks much of the information contained in the annual reports required of private foundations.

b. Treasury proposal

(1) General description. Every private foundation with at least $5,000 worth of assets, and every public charity (other than a church* or an integrated auxiliary thereof) or social welfare organization which has annual gross receipts of at least $100,000 or which makes grants annually of more than a specified minimal amount, would be required to make available to the public, and

*For purposes of these proposals, the term "church" includes a convention or association of churches.

file with the Internal Revenue Service, an annual report regarding its finances, programs and priorities. In addition, any business organization that makes annual charitable contributions of at least $100,000 would be required to make available and file an annual report on its charitable giving programs. This report would be supplied by the organization upon request, at or below cost, during the year following the date it is filed with the Service.

(2) Detailed description.

(a) Organizations Affected. The new reporting requirements would replace the current requirements for private foundations with at least $5,000 worth of assets. In addition, they would apply to every public charity and social welfare organization (exempt under section 501(c)(3) or section 501(c)(4), other than a church or an integrated auxiliary thereof), if it makes total grants of more than a specified minimal amount or it has gross receipts of at least $100,000 for the immediately preceding year (or as an annual average for the five preceding years). The reporting requirements would also apply to business corporations, partnerships and trusts whose annual contributions, together with the amount of direct and indirect expenses attributable to those contributions, totaled at least $100,000 for the preceding year (or as an annual average for the five preceding years).

In determining the amount of gross receipts of a philanthropic organization for any year, the principles in the regulations which now apply in computing gross receipts for purposes of the exemption from the current annual return filing requirement (section 6033) would apply. In determining the $100,000 contribution figure for a taxable corporation, amounts contributed by such a corporation to its company foundation would not be included if the company foundation files an annual report under these provisions.

(b) Contents of report. The Secretary of the Treasury would be provided with regulatory authority to prescribe the contents of the annual report. It is expected that the regulations would require that the report be written in language clearly understandable to a layman and include the following information: a description of the organization's program and priorities; an explanation of the criteria that are taken into account in accepting or rejecting requests for funds, products or services; and financial information, including a statement of income, a statement of expenditures (including fund-raising and administrative expenditures), and a balance sheet.

It is also expected that the regulations would require that, in discussing the criteria which are applied in awarding and rejecting grants, the report would be specific enough so that a prospective applicant could determine the general policies and circumstances under which grants are awarded or rejected. However, the annual report would not be required to disclose the internal decision-making processes of the organization, particularly with respect to individual grant applications.

In the case of a business organization, the information required would be limited to the pertinent aspects of its charitable giving program.

(c) Summary Annual Report. In addition to an annual report, organizations with annual gross receipts of $100,000 or more would be required to make available to the public a summary annual report that is in shorter form and in less detail than the annual report.

The Secretary of the Treasury would also be provided with regulatory authority to allow grant-making public charities with annual gross receipts of less than $100,000 to prepare a summary annual report in place of, rather than in addition to, the basic annual report.

(d) Availability of the Annual Report. Each organization required to file an annual report (or summary report) with the Service would be required to supply the report, or any portion thereof, at or below reproduction cost to any person within 60 days after a request for such report is made, if the request is made within one year from the date such report is filed with the Service.

If the organization does not respond to a request for information within 60 days, or if the request is made after one year from the filing date, the person requesting the information may then seek it from the Service. The Service would not be required to respond to a request within any definite period of time.

(e) Sanctions. Penalties similar to those imposed for failure to file information returns (section 6652(d)) would be imposed on an organization for failure to file an annual report with the Service or to provide the report promptly to a person requesting it, unless any such failure is due to reasonable cause. Since the Service may not be made aware of a failure to provide information in response to a request from the public, consideration should be given to the type of remedy that should be afforded to a person requesting the report when it is not provided on time.

2. Regulation of Interstate Solicitation

a. Present Law

There is no supervision or monitoring of interstate solicitation by the Federal Government, and the State laws affecting it vary considerably, making it easy, particularly for large fund-raising drives, to circumvent tough enforcement by any one State.

b. Treasury proposal

Interstate solicitation would be subject to Federal legislation administered by the Treasury Department. Disclosure would have to be made with respect to certain financial information about the soliciting organization, particularly with respect to its fund-raising and administrative costs. The annual reports filed with the Internal Revenue Service would allow it to check such disclosures readily.

The Treasury Department recommends that Congress conduct hearings on the appropriate methods for regulating such solicitation, with emphasis on the following issues:

1. The extent of financial data concerning the soliciting organization that must be supplied with the solicitation material;

2. The need for administrative review of solicitation material prior to dissemination (as opposed to relying solely on criminal and equitable sanctions for misleading or incomplete material);

3. The appropriate method for regulating oral solicitations (e.g., by telephone or television) and the extent of disclosure required for them;

4. The need for limitations on fund-raising and administrative costs; and

5. The pre-emption of varying State reporting requirements for interstate solicitations, with a uniform Federal report to be filed with all requesting States.

B. Extending Private Foundation Restrictions to Public Charities

1. Self-Dealing

a. Present law

Certain "self-dealing" transactions between a private foundation and any of its "disqualified persons" (basically substantial contributors, foundation managers and related persons) are subject to a two-tier Federal excise tax. Some of these transactions are subject to such a tax whether or not they meet an arms-length standard, and others are subject to tax only if they violate such a standard. The initial tax imposed on the disqualified person is 5 percent per annum of the amount involved (until corrected). He is also subject to an additional tax of 200 percent of the amount involved, if the transaction is not corrected within a specified period . There are similar, but smaller, excise taxes imposed on a foundation manager who knowingly participates in such a self-dealing transaction (without reasonable cause) or refuses to agree to any part of the necessary correction.

No similar sanctions are imposed in the case of a self-dealing transaction with a public charity, although it may lose its tax-exempt status for failing to operate exclusively for charitable purposes.

Under State law there are limited restrictions on such transactions, generally requiring them to meet an arms-length standard.

b. Treasury proposal

Since violations of an arms-length standard are often difficult to prove, and the revocation of an organization's exempt status is usually too severe a sanction for non-repetitative violations, the Treasury Department proposes to extend the self-dealing prohibitions and excise taxes to transactions involving public charities (other than churches and their integrated auxiliaries). As in the case of private foundations, the general rule would be a flat prohibition against the proscribed transactions, with certain transactions being allowed if they meet an arms-length standard.

However, because of the greater variety in the types of organizations, disqualified persons and transactions that would be affected by such an extension of the flat prohibitions, and the greater potential need for administrative flexibility in providing relief from the unforeseen consequences of such an extension, the Secretary of the Treasury would be provided with regulatory authority to provide additional arms-length exceptions to the statutory prohibitions. Such authority should not be authority to promulgate individual exemptions, but merely regulatory authority to provide exceptions for various classes of transactions. Such exceptions would have to be found to be both administratively feasible and beneficial to, as well as protective of, the interests of the public charity. *

*In addition, as a technical point, consideration should be given to changing the amount involved for a prohibited loan from the amount of interest to the full amount of the loan, since the latter is a measure of the loss that the organization may face if the disqualified person has difficulty repaying the loan.

2. Minimum Payout

a. Present law

Under present law, a private nonoperating foundation is subject to a two-tier excise tax if it does not distribute for philanthropic purposes at least 5 percent of its noncharitable assets (generally investment assets), or its adjusted net income, whichever is greater, in the year following the close of its accounting period. For new foundations, there are special liberal rules that allow a set-aside for up to 5 years to qualify as a current distribution under certain circumstances.

Private operating foundations are not subject to this minimum payout requirement, but to qualify for operating status, the foundation must expend at least 85 percent of its adjusted net income directly in the active conduct of its exempt purposes, and must satisfy one of three alternative tests. The alternative tests require the foundation to expend annually 3-1/3 percent of its noncharitable assets directly in such exempt activities, to devote at least 65 percent of its assets directly to such exempt activities, or to receive at least 85 percent of its support from the general public and five or more exempt organizations.

Public charities are not subject to any similar requirements.

b. Treasury Proposal

Every public charity (other than churches and their integrated auxiliaries) and every private operating foundation would be required to make qualifying distributions of an amount that is not less than

3-1/3 percent of its noncharitable assets, in the year following the close of its accounting period. Any excess of its adjusted net income over such minimum amount would not be subject to the payout requirement.

Generally, the rules applicable to private nonoperating foundations for determining the minimum amount of noncharitable assets, the sources of distribution, and what constitutes a qualifying distribution would be applied to public charities and private operating foundations. For example, qualifying distributions would include administrative expenses incurred in the direct conduct of the organization's exempt activities and the cost of acquiring and repairing buildings and other facilities used in such activities. However, to prevent public charities and private operating foundations from avoiding the payout rules by distributing assets back and forth among one another, the distribution by any such organization to another from which it received (directly or indirectly) a contribution in the 5 preceding years would not count as a qualifying distribution. Such a distribution would also increase the recipient's minimum distributable amount* for the year of receipt, to the extent that it effectively repaid a qualifying distribution made by the recipient during the preceding 5-year period.

*Current law treats the repayment of any part of a qualifying distribution of a private nonoperating foundation as merely an increase in its adjusted net income. This rule would be changed so that such repayment would increase the foundation's minimum distributable amount.

The minimum payout for new organizations or organizations whose endowment suddenly increased many times over should be graduated to 3-1/3 percent (or 5 percent for private nonoperating foundations) over a number of years, e.g., five. Alternatively, there could be liberal set-aside rules that would allow, for example, grants to be paid out over several years to allow the granting organization to monitor how they are used.

3. Jeopardy Investments

a. Present law

Private foundations and their managers are subject to a two-tier excise tax when they make investments (other than program-related investments) that jeopardize the carrying out of a foundation's exempt purposes. No such tax is imposed if the investment is not initially a jeopardy investment, but later becomes one and is retained by the private foundation. Nor is an excise tax imposed in the case of a jeopardy investment made or retained by a public charity. However, in both of these latter cases, the trustees or managers of the charity may be subject to fiduciary liability for such investment under State law.

b. Treasury proposal

The tax for making a jeopardy investment would be extended to public charities (other than churches and their integrated auxiliaries).

In addition, the tax would be imposed on any public charity or private foundation (and its managers) which did not dispose of a non-program-related investment within a reasonable period of time after it learned, or should have known, that the investment had become a jeopardy investment, or was in fact a jeopardy investment at the time of its receipt by the organization, e.g., as a charitable contribution.

4. Taxable Expenditures

a. Present law

Under present law, private foundations and their managers who make certain proscribed expenditures or distributions are subject to a two-tier excise tax on the amount of such expenditures or distributions. These "taxable expenditure" provisions do not apply to public charities. Thus, the only sanction generally available for similar expenditures by these organizations, e.g., for non-charitable purposes, is loss of their tax-exempt status. Certain public charities, however, may elect to become subject to specified limits on their lobbying expenditures. An excise tax is imposed on minor violations of these limits, while loss of exemption is reserved for sustained excessive violations.

In addition, a private foundation is required to take certain steps to ensure that the recipient of any of its grants is spending the grant properly if the recipient is not a public charity. This expenditure oversight requirement applies to a grant from one private foundation to another, even though the latter is also subject to the taxable expenditure provisions.

b. Treasury proposal

In general, the taxable expenditure rules for private foundations would be extended to all public charities (other than churches and their integrated auxiliaries). A public charity, however, would not be required to obtain prior Service approval of grants to individuals for travel, study or similar purposes, as private foundations must do. In addition, in the case of a public charity electing to be subject to the specific limits on lobbying expenditures, sanctions for violations of those limits would be limited to those imposed under present law.

At the same time, the expenditure oversight rules for both private foundations and public charities would be limited to cases where the recipient of a grant is not itself subject to the taxable expenditure rules. This would eliminate the present administrative burden that discourages grants from one private foundation to another (in favor of grants to public charities).

C. Enforcement Procedures

1. Alternative Sanctions

a. Present law

Under present law, the only sanction for violation of any of the statutory requirements imposed upon public charities is loss of exemption. The consequences of such a loss are severe; the charity will be unable to receive charitable contributions and its net income (if any) will be subject to tax. Private foundations on the other hand, are subject to two-tier excise taxes for certain violations, as described above. Even these sanctions may be severe, particularly the second-tier tax for failure to correct. The foundation and its charitable beneficiaries may be deprived not only of the funds expended in furtherance of the violation, but also of the funds used to pay the excise tax.

b. Treasury proposal

(1) General description. In addition to having the authority to impose excise taxes on public and private charities as described above, the United States District Courts would be invested with a set of equity powers sufficient to remedy any violation of the substantive rules concerning philanthropic organizations in such a way as to minimize any financial detriment to the organization and to preserve its assets for its philanthropic purposes.

(2) Detailed description.

(a) Equity powers. United States District Courts would be invested with (1) equity powers (including, but not limited to, power to rescind transactions, surcharge trustees and order accountings) to remedy any detriment to a philanthropic organization resulting from any violation of the substantive rules, and (2) equity powers (including, but not limited to, power to substitute trustees, divest assets, enjoin activities and appoint receivers) to ensure that the organization's assets are preserved for philanthropic purposes and that violations of the substantive rules will not occur in the future. For example, the purchase of securities owned by a public charity in a self-dealing transaction could be rescinded if the market value of the assets had increased. If the securities had first increased and then declined, the trustees could be surcharged for depriving the charity of the opportunity to dispose of the assets at a higher price. If the value of the securities declined immediately after the self-dealing transaction, the appropriate remedy might be to do nothing under the equity power.

The mandatory specific sanctions would apply regardless of the action or non-action under the equity powers. Thus, even if no remedies were necessary to protect the charity or preserve its assets for charitable purposes, the imposition of the applicable first-tier excise taxes would be mandatory. However, the Secretary of the Treasury could be given authority to waive the first-tier tax under extenuating circumstances.

(b) Judicial proceedings. Upon institution of an equity action by the Government, power to review excise taxes would be vested exclusively in the District Court. Thus, any action to review excise taxes pending in the Tax Court or Court of Claims would be terminated and be made part of the District Court equity action.

If equity action is necessary, the philanthropic organization and all persons against whom remedies or sanctions are sought would be named as defendants. The extent to which the organization and private persons could all be joined in one suit would depend upon the general rules of venue under the Judicial Code of the United States.

The equity action would spell out the particular specific sanctions and equitable remedies sought against each defendant. Any party's right to a jury trial would be determined under existing law, but the determination of the specific sanctions and appropriate equitable remedies would be determined exclusively by the Court. Thus, for example, any questions of fact concerning the persons who knowingly authorized the organization to engage in a self-dealing transaction could be determined by a jury, in the discretion of the Court; however, the review of the excise taxes and appropriate equitable relief would be determined exclusively by the Court.

(c) Correlation with State authorities. In the event that appropriate State authorities institute action against a philanthropic organization or individuals based upon acts which constitute a violation of substantive rules of law applicable to such an organization, the

United States District Court before whom the federal civil action is instituted or was pending would be required to defer action on any equitable relief for protection of the organization or preservation of its assets for its philanthropic purposes until conclusion of the State court action. At the conclusion of the State court action, the District Court could consider the State action adequate or provide further equitable relief, consistent with the State action, as the case warrants. However, no action by a State court would defer or abate the imposition of the initial Federal excise taxes for the violations. Thus, for example, the institution of a State court action based upon a self-dealing transaction would result in a deferral of any action by the federal court to rescind the transaction. However, the review of the first-tier Federal excise taxes imposed for the specific violation would not be deferred.

In any case where the appropriate sanction or equitable remedy requires one or more distributions to other philanthropic organizations, the governing body of the distributing organization would be given the opportunity to select the appropriate recipients. If the governing body failed to select any such recipients, the appropriate State authorities for supervision of charitable trusts and corporations would be asked to make the choice, with final authority in the District Court in the absence of selection by the distributing organization or State authorities.

Upon loss of exemption by a charity for any reason, the invocation of equity powers to insure that the charity's assets are preserved for charitable purposes would be mandatory. The specific form of the remedy to provide such insurance would be up to the District Court.

2. Audit Tax

a. Present law

Under present law, private foundations are subject to an excise tax of 4 percent on their net investment income. This tax is designed in part to cover the costs of auditing all exempt organizations, but it produces more than twice the revenue needed to cover such costs.

Other exempt organizations are not subject to any such tax.

b. Treasury proposal

The rate of tax imposed on the net investment income of private foundations would be no more than 2 percent.

In addition, if many of the private foundation restrictions were extended to public charities, consideration should be given to repealing the tax altogether.* There would be little justification for imposing this tax only on private foundations, and not on other philanthropic organizations, or other exempt organizations, as well. Extending this tax to such other organizations, however,

*Such a repeal should not, however, result in a reduction of amounts appropriated under section 1052 of the Employee Retirement Income Security Act of 1974 to support the operation of the Office of Employee Plans and Exempt Organizations of the Internal Revenue Service.

would raise serious questions as to (1) whether the net investment income of such organizations is the appropriate tax base for such a tax (and if not, what should it be), (2) what the rate of tax should be, and (3) whether the small amount of revenue collected warrants the imposition of such a tax.

II. Changes Affecting the Charitable Deduction

A. Minimum Tax

1. Present law

Under the Tax Reform Act of 1976, the charitable deduction is made an item of tax preference subject to the minimum tax to the extent that it, along with the individual taxpayer's other itemized deductions (except medical and casualty loss deductions), exceeds 60 percent of the taxpayer's adjusted gross income. This will have the effect of reducing contributions to many philanthropic organizations that already face financial difficulties.

2. Treasury proposal

The charitable deduction would be eliminated as an item of tax preference.

B. Contributions for Foreign Philanthropic Purposes

1. Present law

Under present law, the criteria for the allowance of a deduction in the case of contributions made for foreign philanthropic purposes vary considerably, depending on whether the deduction is for Federal income, estate or gift tax purposes and, particularly in the case of the income tax, on whether the donor is an individual, corporation, trust or estate. For example, courts have allowed a charitable deduction for estate tax purposes even in the case of contributions made to a foreign government or organization, so long as the contribution is to be used only for philanthropic purposes. On the other hand, for income tax purposes a charitable deduction is never allowable to a corporation for a contribution made for foreign philanthropic purposes, unless the recipient is a corporation (not some other entity) created under the laws of the United States.

2. Treasury proposal

To minimize circumvention of the requirements placed on philanthropic organizations to receive and distribute tax-deductible contributions, no charitable deduction would be allowed for income, estate or gift tax purposes unless the contribution is made to an organization which is created under the laws of the United States and which has full control and discretion as to where the contribution is to be distributed or spent. This will subject the expenditure or initial distribution of such contribution to the scrutiny and jurisdiction of the Internal Revenue Service and the Federal courts.

C. Profiting from the Charitable Deduction

1. Present law

Under present law, a taxpayer in the high income tax brackets can, with certain largely appreciated capital assets, obtain a greater after-tax benefit from contributing the property to charity than from selling the property. This anomaly results from the fact that, with respect to a charitable contribution of such an asset, a Federal income tax deduction is allowable for the appreciation in such asset (as well as for its basis), even though such appreciation is never taken into income and subject to tax. Because of the taxpayer's high bracket, his tax savings from the charitable deduction is greater than the after-tax proceeds that he could obtain from selling the property.

For example, assume that a taxpayer in the 70 percent bracket has stock with a basis of $1,000 but a fair market value of $15,000. Assume further that if he sells the stock, the effective tax rate on his capital gain will be 35 percent (this assumes that he takes the 50% deduction for capital gains and is not subject to the minimum tax). His after-tax proceeds from such a sale would be $10,100 ($15,000 - 35% (14,000)). On the other hand, if he contributes the stock to a public charity, he would be entitled to a charitable deduction for the full $15,000, even though none of the $14,000 appreciation is ever included in his income and subject to the capital gains tax. Since he is in the 70 percent backet, such a deduction would save him $10,500 in Federal income tax (70% of $15,000), which is $400 more than he would have left over (after taxes) if he had sold the property. This $400 can be viewed as his "tax profit" from contributing the property.

2. Treasury proposal

While the Federal income tax law should continue to encourage taxpayers to contribute appreciated capital assets to charity, it should not allow high bracket taxpayers to "profit" from such a contribution more than if they had sold the property outright.

Accordingly, the Treasury Department proposes that the Federal income tax deduction for such a charitable contribution be reduced by a sufficient amount to eliminate such a "tax profit." To avoid changing the statutory provisions every time the tax rates change, the Secretary of the Treasury would be given regulatory authority to compute the amount of this reduction.

The proposal would not apply to minimal amounts of untaxed appreciation, e.g., $5,000 or less.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 6 P.M. January 18, 1977

CARTER ANNOUNCES THREE APPOINTMENTS IN TREASURY DEPARTMENT

President-elect Jimmy Carter and Secretary-designate of the Treasury Mike Blumenthal today announced that the President-elect is nominating three sub-cabinet officials for appointment in the Treasury Department.

Nominated as Deputy Secretary of the Treasury is Kenneth S. Axelson, now Senior Vice President and Director of J.C. Penney Company, Inc. Mr. Axelson will become the second ranking official of the Treasury Department. He was previously Deputy Mayor for Finance of the City of New York on loan from J.C. Penney Company for one year.

Mr. Anthony M. Solomon is nominated to be Under Secretary for Monetary Affairs. Mr. Solomon was previously Assistant Secretary of State for Economic Affairs and was Deputy Assistant Secretary of State for Latin America. He also was a special consultant to the House Ways and Means Committee.

Mr. C. Fred Bergsten is nominated to be Assistant Secretary for International Affairs. Mr. Bergsten was recently a Senior Fellow at the Brookings Institution and previously served as Assistant to the President for National Security Affairs. He received his Doctorate Degree from the Fletcher School of Law and Diplomacy.

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TAX POLICY RESEARCH STUDY NUMBER **THREE**

ESSAYS IN INTERNATIONAL TAXATION: 1976

THE DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

CONTENTS

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FOREWORD

This is the third volume in a continuing series of Treasury tax policy research studies analyzing the interactions between tax law and economic policy. The publication of Treasury tax policy studies is part of an ongoing effort by the Office of Tax Policy to clarify tax issues which are sometimes debated with more feeling than understanding. The first two volumes in this series were published in 1968 when Stanley S. Surrey was Assistant Secretary for Tax Policy.

This collection of essays is addressed to international tax issues. Many of the essays represent the cooperative work of economists and lawyers. Both disciplines are applied in an attempt to explain current law and policy considerations, and to evaluate possible changes.

For the most part the essays included in this volume were initially prepared in the spring of 1976 by the Office of International Tax Affairs for consideration by the House Ways and Means Committee Task Force on the Taxation of Foreign Income. The policy analyses contained in these essays evaluate changes which presuppose the foreign tax credit mechanism, the separate taxation of corporations and their shareholders, and other basic elements in U.S. taxation of foreign income. Thus, the changes analyzed for the most part would not require radical departures in the structure of international taxation. The views reflected in these essays are, of course, the opinions of the authors, and do not necessarily reflect the position of the Treasury Department.

The essays cover a range of topics. The essay by Hufbauer and Foster, "U.S. Taxation of Undistributed Income of Controlled Foreign Corporations", provides a broad outline of the manner in which the United States taxes foreign source income. It specifically deals with "deferral" of U.S. taxation of the earnings of foreign subsidiaries until those earnings are distributed to the United States as dividends. The "Tax Treatment of Income from International Shipping", by Field and Gordon, deals with "deferral", the reciprocal exemption, and other issues in the taxation of shipping income. The "U.S. Taxation of Foreign Earned Income of Private Employees" and "U.S. Taxation of Allowances Paid to U.S. Government Employees", both essays by Field and Gregg, are concerned with exceptions to the general principle that U.S. citizens are taxed by the United States on their worldwide income regardless of residence. The essay by Taylor, "Tax Treatment of Income of Foreign Governments and International Organizations", was prompted by the increased volume and changing nature of foreign governmental investment in the United States. The final two essays by Blough and Carlson deal with the complex and often inconsistent approaches taken by states in the taxation of foreign source income.

While these essays by no means exhaust the list of current issues in the field of international tax policy, they are designed to illuminate selected topics which have attracted Congressional interest in recent years.

This volume is affectionately dedicated to the memory of Nathan Norton Gordon who devoted a long and productive career, with the U. S. Treasury Department, to the international harmonization of national tax systems.

Washington, D. C.

Charles M. Walker

Charles M. Walker
Assistant Secretary of the Treasury
for Tax Policy

December 31, 1976

DEDICATION

These papers are dedicated to the memory of Nathan Norton Gordon who, for many years, played a leading role in the formulation of international tax policy for the United States Treasury Department.

As Assistant Director of the Treasury Department's Office of Tax Analysis, then Director for International Tax Affairs, and finally Deputy to the Assistant Secretary for Tax Policy, Mr. Gordon was responsible for advising several Assistant Secretaries for Tax Policy on international tax questions. At the same time, he was the principal U.S. negotiator of tax treaties with other countries to avoid double taxation. In more than 35 years of service, he won the respect and friendship of each of the Assistant Secretaries he served, his colleagues at the Fiscal Committee of the OECD, the Inter-American Center for Tax Administrators, and the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, sponsored by the United Nations.

Nathan Gordon was a man of broad vision, who brought an analytical mind, an appreciation of practicality, a sensitivity to the concerns of others, and a delightful sense of humor to the complex world of international taxation. These papers touch on a few of the topics which were among his many professional concerns. They are dedicated to his memory by the many Treasury colleagues who benefitted from association with Nathan Gordon.

Nathan Norton Gordon, 1915-1976

U. S. TAXATION OF THE UNDISTRIBUTED INCOME OF CONTROLLED FOREIGN CORPORATIONS

Gary Hufbauer

and

David Foster

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I. ISSUE

Since the introduction of the Federal income tax in 1913, the United States has employed a "classical" system of taxing corporations and their shareholders. Under a classical system, corporations and their shareholders are separately taxed. A corporation's tax liability is not affected by the amount of dividends it distributes to its shareholders, and conversely (with limited exceptions) a shareholder's tax liability depends on dividends received, and is not affected by either the amount of tax paid by the corporation or by the corporation's retained earnings and profits.

These principles extend to a U.S. shareholder in a foreign corporation. No U.S. tax is imposed on the U.S. shareholder until (and unless) the shareholder receives dividends from the foreign corporation. This consequence of a classical system of taxation is called deferral, because the U.S. tax on the income of a foreign corporation is deferred until dividends are paid.

The bulk of U.S. investment in foreign corporations is undertaken, not by individual shareholders, but by U.S. based multinational enterprises. So long as earnings are retained abroad by foreign corporate subsidiaries, the U.S. parent corporation pays no U.S. tax on the foreign income. 1/ If taxable corporate earnings are defined the same way abroad as in the United States, and if the host government applies a tax rate lower than the U.S. corporate tax rate of 48 percent, the difference in rates represents a temporary tax saving to the parent corporation.

Multinational firms based in the United States argue that deferral is necessary to allow them to compete on even terms with foreign firms. In their view, tax neutrality requires the same rate of taxation on all firms operating in the same country. The U.S. multinational firms suggest that the termination of deferral would bring about changes in foreign tax practices and dividend distribution rates that would erode or eliminate U.S. tax revenue gains, and that, without deferral, the foreign expansion of U.S. firms would be curbed, profits and U.S. tax revenues might decline, and U.S. exports to foreign markets might fall.

Others object that deferral enables foreign investors to enjoy tax advantages not available to domestic investors. In this view, tax neutrality requires the same taxation of investment at home and investment abroad. Expressing concern for the impact of foreign investment on American jobs, and the loss of potential tax revenue, labor

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1/ The foreign subsidiary may pay dividends, interest, royalties, and management fees to the U.S. parent corporation, and these types of income would, of course, be taxed currently by the United States.

groups in particular have questioned the continuance of deferral. This concern was expressed most strongly in the late 1960s and early 1970s. Since 1972, a system of flexible exchange rates and the DISC legislation have, to some extent, answered the concern over foreign tax advantages.1/

1/ The tax preference provided by the Domestic International Sales Corporation (DISC) was substantially reduced in the Tax Reform Act of 1976.

II. PRESENT LAW

1. Classical system of taxation. Under present law, a corporation and its shareholders are taxed separately. The corporation is taxed on its earnings; the shareholders are taxed on distributed dividends. This is known as a "classical" or separate entity system of taxation. By contrast, under an "integrated" system of taxation, either the taxes imposed on the corporation are claimed (in whole or part) as a tax credit by the shareholder, or the corporation is allowed a reduced tax rate on dividends paid. Britain, France, Germany, Canada, Japan, and other industrial countries have adopted various types of integrated tax systems. The Ford Administration proposed an integrated tax system for the United States, and the proposal is receiving Congressional consideration.

Over the years, the United States has made limited exceptions to its separate entity system of taxation. Certain exceptions are intended to recognize the economic unity of an affiliated group of corporations within the United States, to avoid double taxation when dividends are distributed from one corporation to another, or to encourage small business. Other exceptions are intended to discourage tax abuse by individuals investing in domestic or foreign corporations. Subpart F of the Internal Revenue Code is principally designed to discourage tax abuse by U. S. corporations which control foreign corporations.

2. Exceptions to recognize economic unity and to avoid double taxation.

(a) Consolidated return. Under specified circumstances (Section 1501 of the Internal Revenue Code), related domestic corporations are permitted to file a consolidated return. The consolidated return recognizes the economic unity of a corporate group. Through the mechanism of a consolidated return, the profits of one domestic corporation may be used to offset the losses of another. In this way, related corporations can share their investment risks. 1/ A foreign corporation cannot, however, join a consolidated return. 2/

(b) Dividends received deduction. Dividends distributed from one domestic corporation to another are entitled to an 85 percent or 100 percent dividends received deduction, depending on the extent of affiliation between the two corporations (Section 243). The purpose of the dividends received deduction is to avoid double taxation at the corporate level. Dividends received by a domestic corporation from a foreign corporation are not eligible for the deduction. 3/

1/ Only one surtax exemption can be claimed on the consolidated return.

2/ Certain contiguous country corporations, defined under Section 1504(d), are allowed to join a consolidated return.

3/ The dividends received deduction is available for dividends paid by a foreign corporation which earns at least 50 percent of its gross income from a U. S. trade or business (Section 245).

(c) Subchapter S. Under Subchapter S (Sections 1371-1379), certain small corporations can elect to be treated for tax purposes much like a partnership. If an election is made, there is no corporate tax, and all earnings (whether or not distributed) are taxed to the shareholders. The purpose of Subchapter S is to encourage small business.

3. Exceptions to discourage tax abuse by individuals.

(a) Accumulated earnings tax. The Revenue Act of 1913 contained the antecedents of today's accumulated earnings tax (Section 531). This is a penalty tax imposed on a corporation when it unreasonably accumulates earnings for the purpose of shielding shareholders from personal income taxation.

(b) Personal holding company tax. In 1934, Congress enacted the personal holding company tax (Sections 541-547). This is a penalty tax on the undistributed personal holding company income of a corporation that receives at least 60 percent of its adjusted ordinary gross income from passive investment sources and certain types of personal services, and is owned to the extent of more than 50 percent in value by five or fewer individuals. The tax applies to the corporation and not to the shareholders. The tax can be mitigated if the corporation declares a "deficiency dividend".

(c) Foreign personal holding company. In 1937, Congressional investigation brought to light the formation of "incorporated pocketbooks" abroad by United States citizens. These corporations, designed to collect and retain passive investment income, were domiciled in countries, such as the Bahamas and Panama with little or no corporate income tax. As foreign corporations, they could not be effectively taxed either on their accumulated earnings or as personal holding companies.

The Congressional remedy was to enact the foreign personal holding company legislation (Sections 551-558) which taxes each U. S. shareholder on his pro-rata share of the foreign corporation's undistributed income. Certain tests must be met before the foreign corporation is characterized as a foreign personal holding company. At least 60 percent of its gross income must be derived from passive sources (dividends, interest, rents, royalties, capital gains, income from an estate or trust, personal service income and certain other items), and more than 50 percent in value of the stock must be owned by five or fewer U. S. individuals. When these and other tests are met, each shareholder is deemed to receive a distribution from the foreign personal holding company, and deferral of U. S. tax liability on the foreign income is effectively precluded.1/

1/ The individual shareholders are not permitted to claim a credit for any foreign corporate income tax paid. The deemed paid credit (Section 902) is only available to U. S. corporations.

The foreign personal holding company legislation did not reach foreign investment companies that sold shares widely among U. S. individuals. Such companies, domiciled in low-tax jurisdictions, could thus retain their dividend and interest income free from U. S. tax. The shareholders could later realize the income in the form of capital gains, if and when the shares were sold.

The Revenue Act of 1972 abolished this device in one of two ways. Either the gains realized by the shareholder on disposition of the stock would be taxed as ordinary income to the extent of accumulated earnings (Section 1246), or the foreign investment company could enter a binding election to distribute at least 90 percent of its income annually (Section 1247).

4. Exceptions to discourage tax abuse by corporations.

(a) Section 367. The Internal Revenue Code permits numerous types of tax-free corporate reorganizations. One corporation may acquire another, a subsidiary may merge into a parent, or a corporation may divide into several parts, all without creating a taxable event. The underlying philosophy is that, so long as assets remain in "corporate solution", and are not distributed to individual shareholders, reorganization is a matter of economic convenience for the firm and need not provide an occasion for taxation.

Reorganizations that involve foreign corporations create an exception to this basic philosophy. The concern arose very early that domestic or foreign corporate income that had not previously been taxed by the United States could forever leave its tax jurisdiction through corporate reorganization. In 1932, the predecessor of Section 367 was enacted. It prevents a tax-free exchange involving a foreign corporation unless "it has been established to the satisfaction of the Secretary or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes."

In any reorganization involving a foreign corporation, the U. S. taxpayer must obtain a Section 367 ruling from the Internal Revenue Service that the exchange is not in pursuance of a tax avoidance plan; otherwise, the transaction will be treated as a taxable event. 1/ Often the taxpayer must pay a "toll charge", involving partial recognition of the gain, in order to receive a favorable Section 367 ruling. The ruling might also be accompanied by a closing agreement which preserves the U. S. tax base (Revenue Procedures 68-23 and 75-29).

1/ The Tax Reform Act of 1976 eliminated the necessity for obtaining a Section 367 ruling in certain circumstances.

(b) Subpart F and its exclusions. The early anti-abuse provisions were addressed to situations where an individual U. S. shareholder took advantage of lower U. S. or foreign corporate tax rates, or where a U. S. corporation took advantage of the tax-free reorganization provisions. The Revenue Act of 1962 partially terminated deferral in answer to the tax abuse which can arise when a U. S. parent corporation takes advantage of lower foreign corporate tax rates on ordinary income in tax-haven countries.

The Kennedy Administration originally sought the complete termination of deferral, but Congress adopted a more focused approach. The history and drafting of Subpart F (Section 951-964) indicate that it represents a compromise between the complete termination of deferral and the classical system of taxing foreign corporate income. The purpose of Subpart F is to terminate deferral in tax abuse situations, yet otherwise retain the separate taxation of a foreign corporation and its U. S. shareholders.

Subpart F, as enacted in 1962, taxes U. S. shareholders currently on the income of a controlled foreign corporation when the nature of the corporation and its sources of income combine to exhibit tax haven characteristics. The foreign corporation is potentially subject to Subpart F if it is a controlled foreign corporation (CFC), that is to say, if the voting stock is more than 50 percent owned by U. S. "shareholders", defined as individuals or corporations each controlling at least 10 percent of the voting stock. 1/

If the foreign corporation can establish that it did not have as one of its purposes a substantial reduction in taxes (Section 954(b)(4)), it will not fall within Subpart F. The substantial reduction test is not defined with reference to U. S. taxes. Rather the test is whether taxes have been reduced by comparison with the taxes that would have been imposed by the buying or selling country, or the paying or receiving country, if a third country corporation had not been interposed in the transaction (Regulations 1. 954-1(b)(4), example (1)). A company which was not organized with tax reduction as one of its significant purposes can, however, still have Subpart F income on individual transactions undertaken for the purpose of tax avoidance.

A controlled foreign corporation's income is subject to Subpart F if it is derived from the insurance of U. S. risks, or if it is characterized as foreign base company income. Foreign base company income includes: (i) foreign personal holding company income (interest, dividends, rents, and similar categories of passive income); (ii) foreign base company sales income (income derived by the CFC from selling

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1/ In the case of a controlled foreign corporation that insures U. S. risks, the test is whether more than 25 percent of the voting stock is owned by U. S. shareholders. (Section 957(b)).

or buying personal property to or from a related person, if the property is both produced and sold for use outside the country in which the CFC is incorporated); and (iii) foreign base company services income (income derived from the performance of technical, managerial, or similar services or on behalf of a related person outside the country of CFC incorporation).

When the foreign corporation and the composition of income meet these statutory tests, the U.S. shareholders are generally deemed to receive a distribution of retained earnings and are taxed accordingly, with provisions for a foreign tax credit (Sections 960 and 962). As a backstop to Subpart F, the Revenue Act of 1962 required that when a U.S. shareholder disposes of shares in a controlled foreign corporation, the gains must be reported as ordinary income to the extent of earnings and profits accumulated after 1962 (Section 1248). 1/ This provision forestalls the accumulation of earnings in a CFC not subject to Subpart F, and the taxation of that income at more favorable capital gains rates.

The Revenue Act of 1962 provided several exclusions to the general rule of current U.S. taxation of Subpart F income. The Tax Reduction Act of 1975 repealed or modified four of the exclusions and added one new exclusion. 2/

(i) Minimum distribution. The parent corporation could elect a so-called "minimum distribution". The minimum distribution was a constructive distribution of earnings from CFCs with and without Subpart F income. If the minimum distribution showed that average foreign taxes were equal to a certain percentage or within a certain percentage point range of the U.S. tax rate, the deemed distributions under Subpart F were reduced or eliminated. The minimum distribution election was repealed by the Tax Reduction Act of 1975.

(ii) Less developed country corporations. The Subpart F income of a CFC derived from and reinvested in "qualified investments" in less developed countries was excluded from the definition of foreign base company income. Less developed countries were broadly defined to include all nations outside of industrial Europe, Canada, Japan, Eastern Europe, and the Sino-Soviet Bloc. This exclusion was repealed by the Tax Reduction Act of 1975.

1/ An exception was made for the disposition of shares in a less developed country corporation (Section 1248 (d)(3)).

2/ The Tax Reform Act of 1976 made further minor changes in Subpart F.

(iii) 30-70 rule. If less than 30 percent of CFC income was characterized as foreign base company income, then a special rule provided that none of the income would retain that character and no deemed distribution was required. If between 30 and 70 percent of the income was characterized as foreign base company income, then the actual percentage would have that character and that percentage would be subject to a deemed distribution. Above 70 percent, the entire CFC income would be characterized as foreign base company income and would be deemed distributed. The Tax Reduction Act of 1975 changed the 30 percent rule to a 10 percent rule.

(iv) Shipping income. As originally enacted, Subpart F provided an exclusion from foreign base company income for income derived from, or in connection with, the use of any aircraft or vessel in foreign commerce. The Tax Reduction Act of 1975 required that shipping income be reinvested in shipping operations to qualify for this exclusion. 1/

(v) Agricultural sales. The Tax Reduction Act of 1975 modified the definition of foreign base company sales income to exclude income from sales of agricultural commodities which are not grown in the United States in commercially marketable quantities.

1/ The Tax Reform Act of 1976 provides that income from coastal shipping operations within one country is not base company shipping income if the ships are registered within that country and the company is incorporated locally.

III. ANALYSIS

1. International tax neutrality. Tax neutrality is a broad concept which is often defined in conflicting ways. Whether foreign corporate income is taxed by the United States currently or only when dividends are distributed is one element in a definition of international tax neutrality, but it is not the only element. The relationship between deferral and international tax neutrality must be viewed in the overall context of U. S. and foreign tax rules.

Tax neutrality at the corporate level 1/ for foreign investment can be defined either with reference to the taxation of domestic profits, or with reference to the taxation of the profits of competing foreign firms. These alternative standards are usually designated as "capital-export neutrality" and "capital-import neutrality". In their pure forms, the concepts of capital-export neutrality and capital-import neutrality say nothing about the division of tax revenue between home and host country tax authorities. In principle, either type of neutrality could be reached consistent with various revenue sharing arrangements between the taxing authorities. In practice, under present international rules, each type of neutrality tends to be associated with a certain division of revenue.

Capital-export neutrality is achieved when the total rate of corporate tax on foreign profits is the same as on comparable domestic profits. For example, if the French subsidiary of an American firm pays 40 percent of its profits in tax to France, and if the United States corporate tax rate was a uniform 48 percent, capital-export neutrality would be served by a current U. S. corporate tax of 8 percent on the French subsidiary's profits.

In order to achieve capital-export neutrality under existing domestic tax law, several underlying conditions would have to be met.

First, host country taxes paid should be credited against the home country tax liability, with a refund of excess foreign taxes; alternatively, home country taxes should be credited against the host country tax liability;

Second, foreign income, including undistributed subsidiary earnings, should be taxed currently to the parent corporation by the home country;

Third, the home country should employ the same accounting practices in calculating domestic and foreign profits (in particular, the same depreciation conventions should be used);

1/ This paper does not analyze tax neutrality at the individual level.

Fourth, any capital subsidies provided for investment in the home country (for example, an investment tax credit) should be available for investment abroad. Similarly, preferential taxation of export earnings, such as through the DISC, should be extended to foreign production for export markets;

Fifth, the same treatment should apply to sub-Federal income taxes levied at home and abroad. If state and local taxes are deductible at home, then to the same extent they should be deductible in computing taxable foreign source income;

Sixth, losses of foreign subsidiaries should be deductible to the same extent as the losses of the parent companies.

Capital-export neutrality could alternatively be achieved under a reformed domestic tax law which was free of all corporate tax preferences, and instead taxed corporate income at a uniformly lower rate. In order to achieve capital-export neutrality under such a neutral domestic tax law, several conditions would have to be met, many the same as before.

First, (and this is the main difference), tax preferences for domestic corporate income must be repealed, and nominal corporate tax rates must then be lowered so that there is no net revenue change from the taxation of domestic income;

Second, host country taxes paid should be credited against the home country tax liability, with a refund of excess foreign taxes; alternatively, home country taxes should be credited against the host country tax liability;

Third, foreign income should be taxed currently by the home country;

Fourth, the home country should employ the same accounting practices in calculating domestic and foreign profits;

Fifth, the same treatment should apply to sub-Federal income taxes levied at home and abroad;

Sixth, losses of foreign subsidiaries should be deductible to the same extent as the losses of the parent companies.

A regime of capital-export neutrality, whether achieved under existing domestic tax law or under a neutral domestic tax law, would--unlike present law--encourage U. S. firms to locate their productive facilities wherever pre-tax returns promised to be greater. A firm would be indifferent between a 20 percent pre-tax rate of return on investment in Canada, in Brazil, or in the United States, for it would receive the same after-tax return in all cases. Tax considerations would play no role in investment decisions, pre-tax returns on U. S. investments of equivalent risk would ultimately be equalized around the world, and the United States capital stock would be allocated in a manner designed to maximize world production. 1/

Capital-import neutrality for corporate investment would be achieved if firms of all nationalities operating in one industry--for example, the Italian office equipment industry--paid the same total tax rate on profits earned in the country where the industry is located--in this case Italy. 2/ Pure capital-import neutrality in this situation would emerge if Italian tax law made no differentiation among enterprises of diverse national origin. For example, Italy could not withhold tax on dividends, interest, and royalties paid to foreign corporations unless it also withheld tax on such payments to Italian corporations. Furthermore, foreign nations should make no attempt to impose an additional tax on corporate earnings arising in Italy. Indeed, one way home countries can promote capital-import neutrality is through the unilateral exemption of corporate foreign source income from domestic taxation, as is virtually done by France and the Netherlands. 3/ Under territorial taxation, as this approach is called, the home government relinquishes all tax claims, and the host government collects all the tax revenues arising from the enterprise. However, a revenue sharing arrangement between the host and home countries would equally be consistent with capital-import neutrality.

Capital-import neutrality is sometimes called "competitive" neutrality because firms of diverse national origin compete on an equal tax basis in any particular country and industry. Because tax considerations do not distort competition, capital-import neutrality promotes the most efficient use of resources between firms in that country and industry.

Both in legislation and in bilateral tax treaties, the United States has attempted to ensure the type of tax neutrality appropriate to different situations, while at the same time protecting U. S. tax revenue. Thus, United States taxation of the foreign income of U. S. owned firms embodies a mixture of capital-export neutrality, capital-import neutrality, and revenue protection clauses.

1/ This statement ignores the misallocation caused by tariffs, quotas, and other impediments to free international trade.

2/ When a host country has an integrated system of taxing corporations and their shareholders, the analysis of capital-import neutrality can become more complicated. This discussion envisages a host country with a classical separate entity system of taxation.

3/ France and the Netherlands do tax a small portion of corporate foreign source income.

The keystone of U.S. taxation of American enterprise abroad is the foreign tax credit. Subject to certain limits, U.S. firms may take a credit against their tentative U.S. tax for the foreign income tax levied on the repatriated earnings of foreign corporate subsidiaries1/, on the total earnings of foreign branches, and on interest, rents, royalties and fees paid from foreign sources. The foreign tax credit essentially cedes to the host country the first slice of tax jurisdiction, and hence most of the revenue. To the extent that a U.S. firm repatriates dividends, interest, rents, royalties or fees from its foreign corporate subsidiary, or operates abroad through foreign branches, the foreign tax credit system may come close to ensuring capital-export neutrality.

There are several reasons, however, why existing United States law does not entirely achieve capital-export neutrality. The U.S. foreign tax credit limitation rules operate so that when foreign taxes exceed the tentative U.S. tax on foreign source income, the excess foreign tax credit cannot be claimed currently (but it can be carried forward or carried back to other taxable years). If the excess credit could be claimed without limit, foreign governments could erode U.S. tax revenues on domestic source income. But because the excess foreign tax credit cannot be claimed, capital-export neutrality disappears whenever the foreign tax rate exceeds the U.S. rate. Foreign investment offering a given pre-tax return then becomes less attractive than domestic investment offering the same return.

In addition to the foreign tax credit limit, other features of the law reduce the extent of capital-export neutrality. U.S. parent corporations cannot offset the losses of foreign subsidiaries against domestic income (the losses of foreign branches of U.S. corporations can, however, be offset against domestic income). The investment tax credit is not available for capital expenditures abroad, 2/ and the asset depreciation range (ADR) cannot be used for computing earnings and profits of a foreign subsidiary. 3/ DISC is not available for exports by foreign subsidiaries. Like the limit on applying the foreign tax credit, these measures shield the U.S. Treasury and promote domestic investment, at the expense of capital-export neutrality. Two asymmetries, however, favor foreign over domestic investment: U.S. taxation of foreign subsidiary earnings is deferred until dividends are declared, and foreign sub-Federal taxes may be credited against the tentative U.S. tax, whereas U.S. state and local taxes can only be deducted from earnings.

1/ There is both a direct credit (Section 901) for foreign withholding taxes on dividends, and an indirect credit (Section 902) for foreign taxes paid on the underlying corporate earnings.

2/ Section 48(a)(2).

3/ The tax rules provide that guideline periods, but not the asset depreciation range, may be applied to property predominately used outside the United States (Revenue Procedure 72-10; Regulation 1.964-1(c) (i)(iii)).

To the extent that the earnings of a foreign corporate subsidiary are not remitted as dividends, United States tax practice comes close to achieving capital-import neutrality. No current U. S. tax is levied on those earnings; instead U. S. taxation is deferred until repatriation. (Under the foreign personal holding company legislation and Subpart F, certain kinds of tax haven income may be taxed currently, whether or not repatriated.) When earnings are retained abroad, deferral places the American-owned foreign subsidiary on much the same tax footing as its local competitors. Pure capital-import neutrality cannot be achieved, however, unless the United States (and other countries) abandon their claim to tax foreign source income (although home countries could seek revenue sharing arrangements with host countries) and host countries pursue a strict policy of non-discrimination.

In essence, an American multinational enterprise can elect to have its foreign ventures taxed either under a modified form of capital-export neutrality (by operating through a foreign branch or by distributing the earnings of a foreign subsidiary), or under a modified form of capital-import neutrality (by operating through a foreign subsidiary and retaining the earnings abroad). In neither case is the neutrality pure, and the level of purity partly depends on the host country.

The 1976 revenue consequences of present law, and of possible changes, are summarized in Table 1 for the non-extractive industries. 1/ Corporate pre-tax foreign earnings were about $24.9 billion, foreign taxes were about $10.3 billion (41 percent of earnings) and U. S. tax collections were about $2.0 billion (8 percent of earnings).

A standard of pure capital-import neutrality at the corporate level would require zero U. S. tax collections on corporate foreign source income. The adoption of a territorial system would thus involve a 1976 revenue loss of nearly $2.0 billion by comparison with present collections. This revenue loss could be unilaterally absorbed by the United States, or it could be shared between the United States and various host countries. Capital-import neutrality, in whatever manner achieved, would not of course answer those critics of deferral who wish to increase U. S. tax revenues and promote domestic investment.

A standard of capital-export neutrality under existing domestic tax law would also reduce the revenue collections of U. S. and foreign tax authorities (assuming the revenue loss is shared). In 1976, the net revenue loss from a system of pure capital-export neutrality would have been about $1.2 billion. The net loss represents a combination of revenue effects. If the law were changed to end deferral, to provide a deduction rather than a credit for that portion of foreign taxes which

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1/ The taxation of petroleum and hard minerals involves special considerations which do not easily fit into the concepts of capital-export neutrality and capital-import neutrality. For this reason, Table 1 is confined to the non-extractive industries.

Table 1

Estimated Tax Revenue Consequences in 1976 of Achieving Alternative Standards of International Tax Neutrality with Respect to U.S. Corporations in Non-Extractive Industries
(Millions of Dollars)

	Capital-export neutrality		
	With extension of U.S. domestic tax preferences to foreign investment	With removal of U.S. tax preferences for domestic investment	Capital-import neutrality
Foreign source income of U.S. corporations, before taxes	24,900	24,900	24,900
Present total taxes on the foreign source income of U.S. corporations under current law	12,270	12,270	12,270
Net U.S. taxes	1,970	1,970	1,970
Foreign taxes	10,300	10,300	10,300
Change in total taxes on the foreign source income of U.S. corporations in non-extractive industries	-1,220	-2,990	-1,970
Remove U.S. tax preferences for foreign investment	890	890	
Western Hemisphere Trade Corporation deduction 1/	20	20	
Non gross-up of dividends from LDC corporations 1/	55	55	
Deferral of tax on retained profits of foreign subsidiaries	365	365	
Allowance of credit for foreign taxes comparable to state income taxes	450	450	
Allow credit (or refund) for foreign taxes in excess of overall limitation	-180	-180	
Remove U.S. tax preferences for domestic investment and reduce U.S. corporate tax rate on domestic and foreign source income to 33 percent 2/		-3,700	
Extend U.S. domestic investment tax preference to foreign investment	-1,930		
Investment tax credit	-1,000		
Asset depreciation range	-300		
Domestic International Sales Corporation (DISC) 3/	-630		
Adopt territorial income tax			-1,970
Hypothetical total taxes on the foreign source income of U.S. corporations in non-extractive industries	11,050	9,280	10,300

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1/ These features were repealed, with transition rules, by the Tax Reform Act of 1976.

2/ After the hypothetical repeal of all U.S. tax preferences for domestic investment by the non-extractive industries, the U.S. corporate tax rate could be reduced from 48 percent to about 33 percent (on a broader base) with no change in tax revenue on domestic source income. However, there would be revenue loss on foreign source income, since the applicable tax rate on that income would also drop from 48 percent to 33 percent.

3/ This estimate represents the effect of extending DISC treatment, as modified by the Tax Reform Act of 1976, to export sales of foreign subsidiaries of U.S. corporations.

corresponds to U. S. state and local taxes, and to eliminate certain minor non-neutralities, there would be revenue gains. But these gains would be more than offset if the law were also changed to compensate for foreign taxes in excess of the tentative U. S. tax, and to extend the investment tax credit, the asset depreciation range, and DISC to investment abroad.

A standard of capital-export neutrality under a neutral domestic tax law would likewise reduce the revenue collections of U. S. and foreign tax authorities on U. S. investments abroad. After the repeal of domestic tax preferences, and a compensating reduction in rates so that the corporate tax on domestic income remained unchanged, the nominal U.S. corporate tax rate could be reduced from 48 percent to about 33 percent. As a result, however, current U.S. revenues from foreign source income would decline by $3.7 billion. This would be partly offset by higher revenues from the termination of deferral, from the re-repeal of the Western Hemisphere Trade Corporation deduction, from the gross-up of dividends from less developed country corporations, and from other changes. But a net revenue loss of $3.0 billion on foreign source income would remain after all adjustments.

Few would argue that the United States should unilaterally implement a standard of capital-export neutrality and incur all the associated revenue costs. Such a standard would require tax cooperation between the United States and foreign governments. On the other hand, legislation by the United States to end deferral would not, by itself, move the international tax system closer to a standard of capital-export neutrality. Rather, it would reinforce the existing preferential taxation of corporate profits earned within the United States.1/

2. Constitutional problems. The taxation of a shareholder on the constructive receipt of a corporation's undistributed earnings raises constitutional issues. Can such earnings properly be viewed as "income" under the terms of the Sixteenth Amendment? This issue has recently been litigated in connection with Subpart F. The court decisions upholding Subpart F provide some indication of the potential reach of U.S. tax law if a wider termination of deferral is sought.2/

1/ It should be emphasized that the investment tax credit or DISC can exert a very different impact on investment per dollar of revenue cost than, for example, deferral or the foreign tax credit. Therefore, an examination of total revenue gains and losses under alternative tax systems provides only a rough guide to their impact on the location of investment.

2/ Subpart F has withstood legal attacks based on the due process clause of the Fifth Amendment, the principles of international law, and the Sixteenth Amendment. The Sixteenth Amendment issues are most important, and they are the only ones discussed here. The discussion draws on an unpublished paper by Howard Liebman, "The Tax Treatment of Joint Venture Income Under Subpart F: Some Issues and Alternatives", April 1976.

The Sixteenth Amendment gives Congress the power to impose income taxes. If a tax is not levied on "income", it would be considered a "direct tax" under the ruling in Pollock v. Farmer's Loan Trust (157 U.S. 429, 158 U.S. 601, 1895), and would require apportionment among the states according to population. The opponents of Subpart F have relied on the Pollock opinion to argue that the current taxation of each CFC shareholder's portion of undistributed earnings and profits cannot possibly constitute a tax on "income" and must, therefore, be apportioned among the states as a "direct tax". The basis for this reasoning lies in the decision of Eisner v. Macomber (252 U.S. 189, 1920) holding that a stock dividend on accumulated profits is not "income" under the Sixteenth Amendment. But Macomber was a close decision and has since been undercut by numerous judicial exceptions. Thus, in 1961, the Treasury Department's General Counsel concluded that, "enactment of [Subpart F] is appropriately within the constitutional powers of the Congress both to lay and collect taxes and to regulate commerce with foreign nations."1/

This view has been upheld by the Tax Court:

> The Supreme Court's pronouncements have been to the effect that taxation of undistributed current corporate income at the stockholder level is within the Congressional power. 2/

Although the Supreme Court has not ruled on Subpart F, other courts have endorsed the Tax Court's position. There appears to be no constitutional barrier to the termination of deferral for a wider class of income than that presently defined in Subpart F.

A more general termination of deferral would, however, provide an incentive for U.S. shareholders to "decontrol" their existing controlled foreign corporations and to take minority positions in new ventures rather than establish new controlled foreign corporations. The incentive to escape current taxation might be mitigated if the ownership threshold used to define a controlled foreign corporation were reduced to 50 percent or less. However, a lower threshold might conflict with the "constructive receipt" doctrine underlying both Subpart F and the foreign personal holding

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1/ Memorandum from Robert H. Knight to Treasury Secretary Dillon, June 12, 1961, in President's 1961 Tax Recommendations, Hearings before the House Committee on Ways and Means, 87th Congress, 1st Session (1961), Volume 1, p. 322.

2/ Estate of Leonard E. Whitlock, (59 T.C. 490, 507, 1972; affirmed 494 F.2nd 1297, 10th Circuit, 1974).

company legislation. If the U. S. shareholders are not a closeknit, controlling group that can force the declaration of a dividend, the constitutionality of a lower threshold under the Sixteenth Amendment and the due process clause of the Fifth Amendment must once again be assessed. How can the United States tax a shareholder on an undistributed gain when the shareholder lacks the degree of control required to realize the imputed gain? It may seem "patently unfair and unjust to tax anyone on income which he has not received and which is not within his control." 1/

The most recent cases dealing with Subpart F have indicated that actual control rather than numerical control is the key issue. In Garlock (58 T. C. 423, 1972) "actual control" by U. S. shareholders in a reorganized Panamian subsidiary was found where the U. S. shareholders only owned 50 percent of the subsidiary, and foreign investors, chosen for their sympathy towards the management, owned callable cumulative preferred stock. Hans P. Kraus (59 T. C. 681, 1973; affirmed, 490 F. 2nd 898, 2nd Circuit 1974) presented similar facts. The court looked to substance rather than form and concluded that divestment in order to avoid the impact of Subpart F must result in actual decontrol. These cases suggest that Subpart F might be extended to situations where U. S. shareholders own less than 50 percent of the foreign corporation, provided that U. S. shareholders exercise actual control. 2/

3. Foreign reaction. Any significant change in the U. S. approach to deferral would raise tax treaty questions and might prompt offsetting foreign tax legislation.

(a) Tax treaties. The United States has in force tax treaties with some 37 countries (including extensions to former colonies). Five treaties have been signed and await ratification by the U. S. Senate and foreign parliamentary bodies. Ten tax treaties are in various states of active negotiation.

The deferral of U. S. tax on the income of controlled foreign corporations is not specifically addressed in these treaties. 3/ The

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1/ Statement of Randolph W. Thrower, Hearings before the Senate Committee on Finance, 87th Congress, 2nd Session (1962) part 6, p. 2251.

2/ For a contrary case see CCA, Inc. (64 T. C. 137, 1974). Note that income from the insurance of U. S. risks earned by a foreign corporation which is owned more than 25 percent by U. S. shareholders is presently taxed under Subpart F (Section 953 and 957 (b)). The 25 percent test has not been litigated, and it is not clear whether it furnishes a precedent for a less than 50 percent ownership test in the absence of actual control.

3/ The pending treaty with Egypt takes note of U. S. deferral provisions and their interaction with Egyptian tax incentives.

United States has made no treaty commitments which would preclude partial or total elimination of deferral. However, the classical U. S. system of taxation and the consequent deferral of U. S. taxation of retained foreign corporate earnings are well understood by foreign tax officials, and these elements of U. S. law play an important role in treaty negotiations.

Less developed countries frequently raise the issue of a tax sparing credit. The tax sparing credit is a home country foreign tax credit for taxes waived by the host country, usually through a tax holiday or preferential tax rates designed to encourage a particular industry. The United Kingdom, France, Germany, Japan, Canada and most other industrialized countries grant a tax sparing credit in their bilateral tax treaties with less developed countries. During the 1950's and 1960's, the United States negotiated seven treaties with either a tax sparing credit (Pakistan, India, Israel and the UAR) or, as a substitute, an investment tax credit (Brazil, Thailand, Israel). In none of the seven cases did the credit provisions receive Senate approval. The United States Treasury no longer negotiates treaties with either a tax sparing credit or an investment tax credit.

However, in negotiations with less developed countries, the United States has emphasized that existing U. S. tax law does not frustrate local tax incentives. If the host country chooses to reduce its corporate tax rates as an investment incentive measure, the United States will not absorb the incentive through offsetting taxation so long as the foreign subsidiary reinvests its earnings abroad. Moreover, the U. S. ordering rule for associating dividends with earnings and profits ensures that U. S. taxes need never erode the foreign tax relief, even if earnings are distributed during the post-tax relief period. The United States follows a last-in-first-out rule in tracing dividends to the underlying earnings and profits. Thus, suppose Country X grants a five year tax holiday, and in the sixth year imposes a 45 percent tax on current earnings. During the tax holiday period, the controlled foreign corporation accumulates earnings and profits of $12 million, but distributes no dividends. In the sixth year, the corporation earns $3.63 million (before tax), pays foreign taxes of $1.63 million, and therefore has after-foreign-tax earnings of $2.0 million. A dividend of $2.0 million is distributed to the U. S. parent. The entire dividend is deemed to be paid out of current earnings, and none of the dividend is deemed to be paid out of accumulated earnings. The grossed-up dividend for U. S. tax purposes will be $3.63 million.[1] The net U. S. tax on the

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1/ Under prior law, dividends from a less developed country corporation were not grossed-up, and a different formula was used to calculate the foreign tax credit. The Tax Reform Act of 1976 requires the gross-up of such dividends.

dividend, after allowance for the foreign tax credit of $1.63 million, would be $0.11 million. 1/

The combination of deferral and the dividend inventory rule has proven satisfactory to many of our tax treaty partners. On the one hand, developed countries have not had to negotiate the issue of U. S. tax treatment of their own tax relief provisions for particular regions or industries. On the other hand, less developed countries have often dropped their initial demands for a tax sparing credit or similar provisions. If the United States were to terminate deferral, some treaty countries would no longer be satisfied with existing arrangements. They might seek new negotiations with a view toward provision of deferral by treaty. Alternatively, they might take unilateral statutory steps along the lines in the following discussion.

(b) Foreign statutory change. If the United States limits the extent of deferral, countries which provide tax relief as an incentive measure might narrow the scope of that relief to exclude companies which would be subject to current U. S. taxation. The result could be heavier foreign taxation of U. S. controlled foreign corporations, by comparison with competing firms either owned locally or by third country parent firms. In selected instances, heavier foreign taxation might serve to equalize the taxation of U. S. investment at home and abroad, but it would erode the potential gains in U. S. tax revenue from the termination of deferral, and it might put U. S. firms at a severe competitive disadvantage.

There are several ways foreign taxes on U. S. controlled foreign corporations could be selectively increased. Subsidiaries of U. S. corporations might no longer be eligible for special tax holidays and investment tax credits. For example, under present law Egypt provides tax relief for foreign investors only if the home country does not tax the income either when earned or distributed. Alternatively, foreign countries could make withholding taxes payable on deemed dividend distributions, as well as on actual dividend distributions, and withholding tax rates could be increased.

1/ In this case, the deemed paid foreign tax credit is calculated as:

$$\frac{\text{Dividend}}{\text{Earnings after foreign tax}} \times \text{Foreign corporation income tax}$$

$$= \frac{\$2.0}{\$2.0} \times \$1.63 = \$1.63$$

The tentative U. S. tax before the credit would be 48 percent of $3.63 million, or $1.74 million. After the foreign tax credit of $1.63 million, the net U. S. tax would be $0.11 million.

In cases where the foreign country wished to encourage U.S. firms, methods could be found which would circumvent the U.S. termination of deferral. The foreign country could provide tax relief for joint ventures in which the U.S. corporation held a minority interest, and therefore was not subject to current U.S. taxation. Alternatively, the foreign country could provide U.S. controlled corporations with input subsidies--for example wage or energy subsidies--while taxing the CFCs at rates close to the U.S. corporate rate. This possibility is illustrated in Table 2.

In both situations, the firm has sales of 1,000, raw material costs of 400, and wage costs of 500. In Case A, with U.S. deferral, a tax holiday in the foreign country ensures that the firm realizes after-tax income of 100. In Case B, without U.S. deferral, a wage subsidy of 100 coupled with a foreign corporate tax of 50 percent ensures that the firm still realizes after-tax income of 100.1/ In the eyes of the firm, little has changed.2/ In the first case, the foreign government collects no tax, in the second case, the wage subsidy just offsets the tax, and in both cases the United States collects no tax. It is not clear what the United States would gain by encouraging foreign countries to undertake this sort of fiscal subterfuge.3/

(c) Average foreign tax rates. With the termination of deferral, many foreign countries would be concerned about the U.S. tax status of subsidiaries engaged in particular industries and regions. Reliable foreign tax rate figures for particular industries and regions within individual countries are not available, but national average tax rate figures can be estimated. Although national average tax rates often conceal the situation for individual industries and regions, they do perhaps indicate the nations which would be most seriously affected by the termination of deferral.

Table 3 shows 1974 statutory and realized corporate tax rates, the withholding rate applied to dividends payments to the United States, and the total (corporate and withholding) realized tax rate on grossed-up dividends for more than 60 countries. Realized corporate tax rates are

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1/ The wage subsidy cannot be conditioned on the payment of tax, or it would be regarded as a tax refund for purposes of calculating the U.S. foreign tax credit.

2/ In the long run, however, the firm may respond differently to a wage subsidy than a tax holiday. For example, a wage subsidy might induce the firm to use more labor and less capital to produce a given level of output.

3/ It should be noted that the foreign tax credit mechanism generally encourages foreign governments to tax the aggregate of dividends, interest, rents, royalties, and other foreign income paid to U.S. corporations at a rate near 48 percent.

Table 2

Comparison Between Foreign Tax Relief and Foreign Input Subsidies

	Case A: U.S. taxation with deferral	Case B: U.S. taxation without deferral
	Foreign tax holiday	Foreign corporate tax of 50% plus wage subsidy
Sales	1,000	1,000
Raw materials	400	400
Wages	500	500
Less: wage subsidy	---	(100)
Income before tax	100	200
Foreign tax	---	100
Income after foreign tax	100	100
Deemed or actual dividend distribution	---	100
U.S. tax after foreign tax credit	---	---
Income after all taxes	100	100

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computed as the ratio of taxes paid to the U.S. definition of pre-tax earnings and profits, which is the base from which the deemed paid foreign tax credit is computed.1/ The realized rates are estimated from 1968 data, adjusted for changes in statutory rates between 1968 and 1974.

The figures in Table 3 are confined to the manufacturing sector. Termination of deferral would have its greatest impact on manufacturing. Realized foreign tax rates on mineral income frequently exceed the U.S. tax rate, so deferred U.S. taxation makes no difference. Undistributed corporate earnings arising in the trade, finance, and insurance sectors are to some extent taxed currently under Subpart F (as amended by the Tax Reduction Act of 1975). Thus, low foreign tax rates applied to those sectors are already partly offset by current U.S. taxation.

Table 3 reveals that realized corporate tax rates on manufacturing are generally well below the statutory rate. The median ratio of realized to statutory tax rates in 1974 was approximately 80 percent; in only 11 of the 63 countries did the realized rate exceed the statutory rate.

For purposes of evaluating the consequences of terminating deferral on a country-by-country basis, the correct procedure is to compare foreign total realized tax rates on grossed-up dividends with the U.S. statutory corporate rate of 48 percent.2/ The U.S. foreign tax credit is so designed that the termination of deferral would usually result in higher U.S. taxation of retained corporate income in those countries with realized tax rates below the U.S. statutory rate.3/ Table 3 reveals that, in 1974, 26 countries imposed a total realized tax rate on grossed-up dividends above the U.S. statutory rate of 48 percent, while 37 countries imposed total realized rates below the U.S. statutory rate. The partial or complete termination of deferral would

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1/ The term "realized tax rate" indicates the ratio between taxes paid and earnings and profits, as reported for U.S. tax purposes. By contrast, the term "effective tax rate" often refers to the ratio between taxes paid and book income, as reported for financial purposes. Foreign effective rates for selected countries are reported in Survey of Current Business, May 1974 (Part I).

2/ The realized U.S. corporate tax rate on domestic source income was about 41 percent in 1974, but the U.S. statutory rate--not the U.S. realized rate--applies to foreign source income.

3/ This generalization does not apply to U.S. firms which use the overall limitation in reporting the foreign tax credit (as they must under the Tax Reform Act of 1976) and also have excess foreign tax credits.

Table 3

Statutory and Realized Corporate Income Tax Rates on Manufacturing Firms, 1974

Country	Statutory Tax Rates: Corporate Tax Rate 1/	Statutory Tax Rates: Distributed profits tax rate, if different 2/	Statutory Tax Rates: Local Income taxes	Realized Corporate tax rate 3/	Withholding tax rates on dividends distributed to U.S.: Statutory or Treaty Rate	Withholding tax rates on dividends distributed to U.S.: Realized Rate on grossed-up dividends	Total realized tax rate on grossed-up dividends
Canada	48.0		13.0	41.1	15.0	8.8	49.9
Europe:							
Austria	55.0	27.5	15.0	53.4	5.0	2.3	55.7
Belgium	42.0	0 4/		37.5	15.0	9.4	46.9
Denmark	36.0			32.5	5.0	3.4	35.9
France	50.0	25.0		48.0	5 0	2.6	50.6
Germany	51.0	15.0	13.0	43.0	15.0	8.5	51.5
Greece	38.2	0 4/		11.9	30.0	26.4	38.3
Ireland	50.0	27.0	5/	12.7	5.0	4.4	17.1
Italy	43.8			41.9	5.0	2.9	44.8
Luxembourg	40.0		14.0	17.1	5.0	4.1	21.2
Netherlands	48.0			36.0	10.0	6.4	42.4
Norway	26.5	0 4/	21.3	40.5	15.0	8.9	49.4
Spain	32.8			30.3	15.0	10.5	40.8
Sweden	40.0		25.0	43.1	5.0	2.8	45.9
Switzerland	8.8		28.0	27.1	5.0	3.6	30.7
United Kingdom	52.0	26.2		44.6	15.0	8.3	52.9
Oceania:							
Australia	47.5			42.9	15.0	8.6	51.5
New Zealand	45.0			51.7	5.0	2.4	54.1
Latin America:							
Mexico	42.0			42.2	20.0	11.6	53.8
Argentina	42.9			28.2	12.0	8.6	36.8

Table 3 - continued

Country	Statutory tax rates: Corporate tax rate 1/	Statutory tax rates: Distributed profits tax rate, if different 2/	Statutory tax rates: Local income taxes	Realized corporate tax rate 3/	Withholding tax rates on dividends distributed to U.S.: Statutory or treaty rate	Withholding tax rates on dividends distributed to U.S.: Realized rate on grossed-up dividends	Total realized tax rate on grossed-up dividends
Brazil	30.0	33.5		30.3	25.0	17.4	47.7
Chile	41.7			39.4	40.0	24.2	63.6
Columbia	36.0			47.3	20.0	10.5	57.8
Ecuador	20.0	40.0		18.7	40.0	32.5	51.2
Peru	55.0			47.7	30.0	15.7	63.4
Uruguay	37.5			25.2	25.0	18.7	43.9
Venezuela	50.0			30.0	15.0	10.5	40.5
Costa Rica	40.0			33.7	15.0	9.9	43.6
El Salvador	15.0			7.6	38.0	35.1	42.7
Guatemala	52.8			21.0	10.0	7.9	28.9
Honduras	40.0			25.2	5.0	3.7	28.9
Nicaragua	30.0			1.8	0.0	0.0	1.8
Panama	50.0			15.4	10.0	8.5	23.9
Africa:							
Algeria	50.0			0.0	18.0	18.0	18.0
Morocco	48.0			54.5	25.0	11.4	65.9
Liberia	45.0			5.7 6/	15.0	14.1	19.8
Ethiopia	40.0			38.6	0.0	0.0	38.6
Kenya	40.0			19.0	12.5	10.1	29.1
Nigeria	45.0			4.7	15.0	14.3	19.0
Rhodesia	40.0			30.9	15.0	10.4	41.3
South Africa	43.0			41.9	15.0	8.7	50.6
Zambia	45.0			28.0	15.0	10.8	38.8
Middle East:							
Iran	10.0	55.0	3.4	10.5	60.0	53.7	64.2
Israel	56.5	42.0		44.7	30.0	16.6	61.3
Lebanon	42.0		15.0	15.1	10.0	8.5	23.6
Asia:							
Sri Lanka	60.0	33.3		21.2	39.3	31.0	52.2
India	60.0			57.0	25.7	11.1	68.1

Table 3 - continued

Country	Statutory Tax Rates: Corporate Tax Rate 1/	Statutory Tax Rates: Distributed profits tax 2/ rate, if different	Statutory Tax Rates: Local Income taxes	Realized Corporate tax rate 3/	Withholding tax rates on dividends distributed to U.S.: Statutory or Treaty Rate	Withholding tax rates on dividends distributed to U.S.: Realized Rate on grossed-up dividends	Total realized tax rate on grossed-up dividends
Malaysia	40.0			27.9	40.0	28.8	56.7
Pakistan	60.0			52.6	15.0	7.1	59.7
Phillippines	35.0			29.6	35.0	24.6	54.2
Singapore	40.0			26.9	40.0	29.2	56.1
Taiwan	25.0			6.0	10.0	9.4	15.4
Thailand	30.0			14.9	25.0	21.3	36.2
Hong Kong	15.0			15.5	0.0	0.0	15.5
Japan	40.0	28.0	12.0	47.4	10. 0	5.6	53.0
Indonesia	45.0			36.4 6/	20.0	12.7	49.1
Other Western Hemisphere:							
Bahamas	0.0			5.1	0.0	0.0	5.1
Bermuda	0.0			0.3	0.0	0.0	0.3
Netherlands Antilles	34.0		15.0	4.5 6/	0.0	0.0	4.5
Dominican Republic	41.1			21.7	18.0	14.1	35.8
Jamaica	45.0			22.6	37.5	29.0	51.6
Puerto Rico	40.0			12.2	15.0	13.2	25.4
Trinidad & Tobago	45.0			36.7	10.0	6.3	43.0

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NOTES: 1/ For some countries, 1974 rates were unavailable and 1973 rates were used.
2/ The distributed profits tax rate reflects both split rates and imputation systems.
3/ Estimated by increasing (or decreasing) the 1968 realized corporate rate for manufacturing by the percentage change in the statutory corporate rate.
4/ Dividends are fully deductible from earnings in Greece and Norway; in Belgium, they are deductible within limits.
5/ Included in the corporate rate.
6/ This is the realized rate for all industries

SOURCES: M.E. Kyrouz, "Foreign Tax Rates and Tax Bases," National Tax Journal, March 1975; unpublished data.

principally affect U.S. investment in the 37 countries in the latter category. Of these 37 countries, 27 were less developed countries which presumably rely on tax relief to promote development.

4. Administrative aspects. U.S. "shareholders" in a controlled foreign corporation are required to report the CFC's earnings and profits under U.S. accounting standards. This information is needed to calculate the deemed paid foreign tax credit. 1/ In most cases, therefore, the elimination of deferral would require little information not already reported for U.S. tax purposes. 2/

However, in practical terms, the Internal Revenue Service would need to expand its auditing efforts and its staff of international specialists very substantially if deferral were terminated. The present IRS staff includes some 150 international specialists. These specialists are responsible for questions concerning international pricing and allocation of expenses, Subpart F, DISC and similar special status corporations, and other international tax issues. In 1974, about 700 international audits were completed.

Under existing law, the direct and deemed paid foreign tax credits are generally more than sufficient to offset U.S. tax liability on dividends from foreign subsidiaries. From a practical standpoint, therefore, it is not rewarding for the Internal Revenue Service to examine the majority of CFC returns (in 1974, about 40,000 CFC returns were filed). But with the partial or complete termination of deferral, the exact calculation of the earnings and profits of a foreign subsidiary would become more important. The IRS would have to increase its international staff very substantially to meet the new demands.

1/ The deemed paid credit (Section 902) is calculated as:

$$\frac{\text{Dividends}}{\text{Earnings and profits}} \times \text{Foreign income tax} = \text{Deemed paid credit}$$

The denominator of the first term on the left must be calculated according to U.S. accounting standards. Note that earnings and profits is an after-tax concept.

2/ Additional information would be required to the extent that the definition of earnings and profits for purposes of the deemed paid foreign tax credit (Sections 902 and 964) differs from the general definition of earnings and profits. Moreover, CFCs that presently distribute no income would now be required to report earnings and profits.

5. Investment impact. With the termination of deferral foreign subsidiary corporations, facing a higher tax rate than competing local firms, might diminish their activities. Out of a given volume of pre-tax earnings, CFCs would have fewer funds available for reinvestment. In order to maintain the same after-tax earnings as a percentage of investment, they might sacrifice less profitable product lines and, where possible, they might raise prices. As a result, CFC sales abroad might contract. But there is a wide range of opinion on the ensuing consequences for investment in the United States.

Some observers believe that investment would be partly shifted back to the United States, thereby increasing economic activity in the United States and domestic corporate earnings. These observers contend that foreign and domestic investment are at least partial substitutes, and that, when markets and investment opportunities are lost in one area, multinational firms will reallocate their resources to another part of the globe.

Other observers contend that little or no investment would be shifted back to the United States. They argue that profitable investment and production opportunities are highly specific both in time and place, and that the loss of foreign markets abroad does little to create new investment opportunities in the United States. Indeed, the loss of foreign markets might impair the access of American producers to new foreign technology, and might impede the realization of economies inherent in large scale production and international specialization, with a consequent attenuation of domestic investment opportunities.

Professor Horst has constructed a mathematical model to simulate the impact of terminating deferral on manufacturing investment in the United States and abroad.1/ In this model, foreign and domestic investment are assumed to be partial substitutes for one another. Investment in each location is determined both by relative after-tax rates of return, and by the firm's overall supply of financial resources. The model assumes that a multinational manufacturing firm maximizes its global after-tax earnings. The firm invests both in the United States and in a single foreign country. Its investment can be financed out of its own retained earnings, with new equity capital, or with borrowed funds, raised either in the American or in the foreign capital markets. U.S. funds can be transferred to the foreign affiliate either as equity capital or as interest-bearing debt. The division of taxable income between countries depends on investment and sales in each country, and on the level of deductible intrafirm expenses, such as interest payments, royalties, and head-office charges.

1/ Thomas Horst, "American Multinationals and the U.S. Economy", American Economic Review, May 1976.

A change in tax policy, either in the United States or abroad, will have two conceptually distinct effects: a substitution effect, resulting from any change in the after-tax rate of return on foreign or domestic investment; and a liquidity effect, resulting from any change in after-tax earnings available for reinvestment. The size of the substitution and liquidity effects depends not only on the opportunities for investing and borrowing in the two countries, but also on the firm's own internal use of debt and equity capital.

Although the model is basically simple, it requires more than thirty equations to capture the details of foreign and domestic investment opportunities and tax systems. Many parameters must be estimated before usable results can be obtained. As in any exercise of this nature, the results are subject to a considerable margin of error.

The results are summarized in Table 4. The estimates portray the investment impact after complete adjustment to the termination of deferral. Complete adjustment could, of course, require several years. Both the substitution effect and the liquidity effect are reflected in the estimates.

The estimates in Table 4 suggest that the stock of plant and equipment investment in the United States manufacturing sector might ultimately increase by $2.2 billion (a change of 0.7 percent) with an end to deferral, while the stock of U.S. owned manufacturing assets abroad might ultimately decrease by $3.5 billion (a change of 2.3 percent). Consolidated after-tax earnings would decrease by about $980 million. U.S. corporate taxes would increase by about $1,000 million, while foreign corporate income and withholding taxes would decline by about $210 million. These revenue estimates, like the underlying investment impact estimates, are based on the assumptions of the particular model.1/

Professor Horst's model attempts to capture a variety of interactions between U.S. parent corporations and their foreign subsidiaries. Even so, the model requires many simplifying assumptions. In particular, the following complicating factors are not considered.

The model assumes that foreign and domestic investments are partial substitutes, and then proceeds to calculate the extent of substitution. Many observers would dispute the assumption of a substitute relationship between foreign and domestic investment. If the assumption is wrong, the estimates of additional investment in the United States and larger U.S. tax revenues are also wrong.

1/ Revenue estimates made under various assumptions are presented in Section 7.

Table 4

Estimated Impact of Terminating Deferral on Selected
Economic Variables for U.S. Multinational Manufacturing Firms 1/
(Millions of Dollars)

	Initial Values	Estimated Changes
Total domestic assets 2/	314,000	2,200
Total foreign assets 2/	151,000	-3,500
Consolidated after-tax earnings 3/	28,500	-980
U.S. corporate income tax on domestic and foreign income after investment tax credit and foreign tax credit 3/	13,400	1,000 4/
Foreign corporate income and dividend withholding taxes	7,700	-210 5/

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Sources: The estimated changes are adapted from estimates made by Thomas Horst, "American Multinationals and the U.S. Economy," Fletcher School of Law and Diplomacy, November 1975, and unpublished work. The initial values are derived from: U.S. Senate, Committee on Finance, Implications of Multinational Firms for World Trade and Investment and Labor, February 1973; Survey of Current Business, October 1975; Statistical Abstract of the United States, 1975; U.S. Treasury Department, Statistics of Income 1972: Corporation Income Tax Returns.

1/ The initial value figures refer to the year 1974. The estimated change figures represent the impact after complete adjustment to the termination of deferral. The figures in the estimated change column include the impact resulting from the extension of Subpart F in the Tax Reduction Act of 1975.

2/ The initial value figures are based on the 1970 estimates for giant multinational manufacturing firms contained in Implications of Multinational Firms, p. 432, increased to reflect smaller manufacturing firms with overseas investment (15 percent of total overseas investment), and increased again to reflect growth between 1970 and 1974 (Statistical Abstract of the United States, 1975, p. 500; Survey of Current Business, October 1975). The foreign asset figures include investment by foreigners in U.S. affiliates. The estimated changes are based on Professor Horst's model.

3/ The initial values refer to the consolidated after-tax earnings and U.S. and foreign income taxes for all manufacturing firms claiming a foreign tax credit. The estimated changes are based on Professor Horst's model.

4/ This estimate reflects additional U.S. taxes from: (i) Subpart F as expanded by the Tax Reduction Act of 1975 ($250 million); (ii) termination of deferral with worldwide pooling, an overall foreign tax credit limit, and current dividend distribution rates ($365 million); (iii) an increase in U.S. investment and the greater use of equity capital in the United States ($385 million). Detail is shown in Table 11.

5/ This estimate reflects a decline in foreign taxes resulting from: (i) a decrease in foreign investment; (ii) the greater use of debt capital for foreign affiliates.

Professor Stobaugh, for example, contends that the termination of deferral could lead to a cumulative decline in the profitability and investment both of foreign affiliates and their U.S. parent corporations.1/ The U.S. multinational firms would have fewer funds available for reinvestment, and in order to maintain the same after-tax rate of return, they might concede some business to competing foreign firms. With slower growth and smaller sales, they might be less able to improve techniques of production, and they would have a smaller base for spreading research, administrative, and other fixed costs. The cumulative effect could be lower profits and a decline in investment, both in the United States and abroad.

Apart from investment changes resulting from corporate decisions, foreign governments might alter their own tax rules in response to the termination of deferral. The changes could be designed not only to offset U.S. revenue gains, but also to counter any shift of investment towards the United States. For example, foreign governments might provide special investment incentives for non-American firms. Through bank financing and other avenues, these incentives could indirectly attract capital from the United States.

These considerations suggest that the changes portrayed in Table 4 should be viewed as upper-limit estimates of the investment impact of terminating deferral.

6. Financial impact. Foreign subsidiaries can finance their expansion either by issuing debt or by increasing equity capital (including the retention of earnings). The funds can be provided either by the parent corporation or by unrelated investors. A change in deferral would affect the tax cost of only one source of capital, namely equity funding provided by the parent corporation. Other sources of capital would be available on the same tax terms as before. With a limitation on deferral, the foreign affiliate thus might find it more advantageous to finance expansion through external local borrowing, or through intrafirm debt, rather than through equity capital supplied by the U.S. parent corporation. 2/ The net effect is that a larger share of earnings might be paid out as interest and a smaller share might be retained or paid out as dividends.

1/ Robert B. Stobaugh, "The U.S. Economy and the Proposed U.S. Income Tax on Unremitted Earnings of U.S. Controlled Foreign Manufacturing Operations Abroad", Harvard Business School, 1975.

2/ Financial shifts of this type are included in Professor Horst's model of investment decisions discussed in the previous section.

Table 5 presents a hypothetical example to illustrate the case in which local borrowing is increased after the termination of deferral. For simplicity, a U. S. corporate tax rate of 50 percent and a foreign corporate tax rate of 25 percent are assumed. Foreign earnings before interest charges are kept constant throughout the analysis, implying the same real level of foreign activity. 1/ No dividends are distributed from subsidiary to parent, and thus no withholding taxes are paid.

The parent firm can choose between raising a certain amount of debt abroad, limited to 200 in this example, or financing the affiliate entirely with equity capital. If it raises debt abroad, the parent can reduce its equity commitment to the foreign affiliate and increase its use of equity capital in the United States. The interest rate on foreign debt is assumed to be 10 percent, while domestically owned assets are assumed to earn 15 percent before tax. Domestic assets thus earn a higher pre-tax return than the cost of foreign debt. This is a crucial assumption; otherwise it would not be sensible for the firm to incur the risk of borrowing abroad.

Under present U. S. law, the firm would be indifferent between borrowing abroad and financing the affiliate entirely with equity. In both cases, its total after-tax income would be 175. 2/

If deferral is terminated, the outcome changes. The firm's total income after tax declines, and U. S. tax collections rise. Equally important, the firm now has an incentive to borrow abroad. Consolidated income after tax would be 150 with all equity financing and 155 with some local debt. The hypothetical firm can thus increase its after-tax income by redeploying some of its assets from investment in the foreign subsidiary to investment in the United States. The process of redeployment would increase U. S. tax from 125 to 135. The partial or complete termination of deferral could place some U. S. firms' foreign subsidiaries in the position of this hypothetical firm. They might find it advantageous to substitute local borrowing by the affiliate for equity capital supplied by the parent firm. 3/

1/ In fact, foreign operations would probably contract in face of the higher tax burden on foreign earnings.

2/ The tax authorities of the two countries are not, however, indifferent to the means of finance. The substitution of local debt for equity capital would reduce the foreign corporate tax from 25 to 20 and increase the U. S. corporate tax from 100 to 115.

3/ A similar example could be devised to illustrate the effect of substituting intrafirm debt for equity financing.

Table 5

The Effect of Deferral on the Use of Local Debt by a Hypothetical Foreign Subsidiary 1/

	With U.S. Deferral		Without U.S. Deferral	
	All Equity Finance (1)	Some Local Debt (2)	All Equity Finance (3)	Some Local Debt (4)
Foreign Subsidiary 2/				
1. Foreign earnings before interest charges	100	100	100	100
2. Interest paid locally	0	20	0	20
3. Foreign taxable income	100	80	100	80
4. Foreign corporate tax at 25 percent	25	20	25	20
5. U.S. corporate tax at 50 percent, after credit	0	0	25	20
6. Foreign income after all taxes	75	60	50	40
U.S. Parent				
7. Domestic taxable income	200	230	200	230
8. U.S. corporate tax on domestic income at 50 percent	100	115	100	115
9. Domestic income after tax	100	115	100	115
Consolidated Results				
10. Total income after tax	175	175	150	155
11. Total U.S. tax	100	115	125	135

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1/ The following assumptions are made: (a) the foreign interest rate equals 10 percent; (b) the foreign debt in cases (2) and (4) equals 200, and the addition to domestically owned assets also equals 200; (c) pre-tax earnings equal 15 percent of domestically owned assets; (d) no actual distribution of dividends is made from the subsidiary to the parent.

2/ The foreign subsidiary is 100 percent owned by the U.S. parent corporation.

It is difficult to estimate the potential importance of tax-induced changes in means of finance. Many firms may have already borrowed abroad as much as they realistically can. Foreign debt has advantages, but it also has risks--in particular the risk of credit rationing with a change in government policies abroad. Likewise, there may be administrative and other limits on intrafirm debt.

Table 6 illustrates the extent of debt and equity financing by foreign affiliates in 1972. New foreign debt supplied a major part of available funds, ranging between 38 percent in the case of manufacturing affiliates to 57 percent in the case of other industries. Intrafirm debt and other debt from U. S. sources supplied between 8 and 25 percent of available funds. New equity capital from the United States only supplied between 4 and 6 percent, while retained earnings supplied between 16 and 45 percent of available funds. There appears to be little scope for the substitution of fresh debt for fresh equity capital, but fresh debt might, to a limited extent, replace retained earnings.

7. Revenue impact. In general, revenue estimates are made to indicate actual or potential U. S. tax collections resulting from the existing tax structure or a change in that structure. The focus here is on changes in tax revenue resulting from the partial or complete elimination of deferral, or the selective expansion of Subpart F. Background estimates are also given for present tax revenues attributable to Subpart F. The Tax Reduction Act of 1975 substantially extended the scope of Subpart F, and correspondingly reduced the scope of remaining revenue gains from the termination of deferral. These effects are reflected in the comparison between estimates for 1974 and 1976 in Table 7. Note that the collateral tax changes enumerated in Table 1 which would move the United States closer to a system of capital-export neutrality are not shown in Table 7. Instead, Table 7 focuses on the taxation of undistributed earnings viewed in isolation. The estimates of possible revenue gains from the further termination of deferral are influenced both by the policy option chosen and by possible behavioral changes.

(a) Policy options. The revenue estimates obviously depend on three important policy choices: (i) the extent to which deferral is eliminated or Subpart F is extended; (ii) whether the overall or the per-country limitation is applied to the foreign tax credit (under the Tax Reform Act of 1976, virtually all firms must use the overall limitation); (iii) the extent to which foreign subsidiary losses are permitted as an offset against foreign subsidiary profits. The policy options are analyzed in Part IV. Tables 8 and 9 present revenue estimates for the alternative policies. The revenue estimates are based on the standard assumption of no behavioral change, discussed in the following subsection (b).

Certain important features should be noted. Under prior law, the great majority of firms customarily elected the overall limitation in calculating the foreign tax credit. Under the Tax Reduction

Table 6

Financing of Foreign Affiliates, 1972 1/
(Percent of Total Funds)

	Petroleum	Manufacturing	Other
Source of funds:			
1. Internal funds:			
Retained earnings	15.6	45.1	23.8
2. External funds:			
Equity capital:			
U.S. owned 2/	4.5	5.5	4.1
Foreign owned	0.1	3.4	3.9
Debt capital:			
U.S. owned:			
intrafirm debt 2/	24.2	5.0	5.9
unrelated financial institutions	0.7	2.8	5.0
Foreign owned:			
related firms	1.9	1.8	20.1
unrelated financial institutions	53.0	36.4	37.2
Total	100.0	100.0	100.0

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Source: U.S. Department of Commerce, Survey of Current Business (July 1975).

Detail may not add to totals due to rounding.

1/ Estimates are based on a sample of majority-owned foreign affiliates.

2/ The apportionment of funds between U.S. owned equity and intrafirm debt was based on the ratio of net equity to total net capital outflows for 1973 reported in U.S. Department of Commerce, Survey of Current Business (October 1975), p. 47.

Table 7

Actual Revenue from Subpart F and
Potential Revenue from Termination of Deferral,
with Overall Limitation on Foreign Tax Credit
(Millions of Dollars)

	1974 Calendar Year Tax Liabilities	Changes Resulting from the Tax Reduction Act of 1975	1976 Calendar Year Tax Liabilities 1/
Total actual and potential revenue from current taxation of CFC retained earnings	615	n.a.	615
Potential revenue from the termination of deferral, total 2/	590	-225	365
Mining	0	0	0
Petroleum and Refining	0	0	0
Manufacturing	577	-215	362
Other	13	-10	3
Actual revenue from Subpart F, total	25	225	250
Pre-1975 revenue	25	n.a.	25
Tax Reduction Act changes 3/		225	225

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n.a. indicates not applicable.

1/ It is assumed that there was no change between 1974 and 1976 in corporate foreign source income affected by deferral.

2/ These estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) foreign subsidiary losses are fully offset against foreign subsidiary profits; (iii) all firms use the overall limitation in calculating the foreign tax credit; (iv) no behavioral change.

3/ The Tax Reduction Act changes were: (i) eliminate minimum distribution ($100 million); (ii) eliminate the less developed country corporation exception ($15 million); (iii) change the 30-70 rule to a 10-70 rule ($75 million); (iv) repeal the shipping exclusion ($35 million).

Table 8

Revenue Changes from Alternative Proposals to End Deferral 1/
(Millions of Dollars)

Required Percentage Distribution 2/	1976 Calendar Year Tax Liabilities 3/			
	Earnings and Profits		Earnings and Profits Plus Branch and Royalty Income	
	Overall Limitation	Per-country Limitation 4/	Overall Limitation	Per-country Limitation 4/
100	$ 365	$ 630	$ 365	$ 630
75	215	385	150	250
50	55	150	10	50

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1/ The estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) CFC profits and losses are consolidated on the same basis as the foreign tax credit limitation that is, either on an overall or a per-country basis; (iii) no behavioral change, in particular the current dividend distribution rate is maintained.

2/ With a 100 percent required distribution, deferral is totally ended. With a 75 percent or 50 percent required distribution, U.S. parent corporations would be deemed to have received the difference between 75 percent or 50 percent of income (defined either as earnings and profits or as earnings and profits plus branch and royalty income) and the amount actually received (either dividends or dividends plus branch and royalty income).

3/ These figures represent additions to 1976 revenues collected under Subpart F ($250 million).

4/ These estimates assume that the per-country limitation is already in place, and that deferral is then ended. The revenue changes refer only to the additional impact of eliminating deferral.

Table 9

Termination of Deferral with Alternative
Consolidation Requirements and with Current
Dividend Distribution Rate 1/
(Millions of Dollars)

	1976 Calendar Year Tax Liabilities 2/
Overall limitation on foreign tax credit	
Worldwide consolidation of CFCs	365
No consolidation of CFCs	1,100
Per-country limitation on foreign tax credit 3/	
Country consolidation of CFCs	630
No consolidation of CFCs	1,300

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1/ These estimates are variants of the estimates in Table 5. The estimates assume: (i) dividends from less developed country corporations are "grossed up"; (ii) no behavioral change, in particular, the present dividend distribution rate is maintained.

2/ These figures represent additions to the 1976 revenue collected under Subpart F ($250 million).

3/ These estimates assume that the per-country limitation is already in place, and that deferral is then ended. The revenue changes refer only to the additional impact of eliminating deferral.

Act of 1975, petroleum firms were required to use the overall limitation for foreign oil related income in taxable years ending after December 31, 1975. Under the Tax Reform Act of 1976, compulsory use of the overall limitation was extended to all firms for taxable years beginning after December 31, 1975.1/ Transition rules were provided for mining companies and firms operating in U.S. possessions. The overall limitation permits extensive tax averaging between income from high-tax and low-tax jurisdictions. Thus, the elimination of deferral coupled with the overall limitation produces less revenue than the elimination of deferral coupled with the per-country limitation.

If losses are not allowed as an offset against profits as between related subsidiaries, the revenue estimate becomes much larger. This reflects the substantial losses experienced by foreign subsidiaries. Contrary to popular belief, it is not true that the bulk of foreign losses are concentrated in foreign branches. Rough estimates for 1975 indicate that foreign subsidiaries experienced losses of $2.2 billion while foreign branches had losses of $0.3 billion.

(b) Behavioral change. Revenue estimates are usually based on a standard assumption of no behavioral change. The standard assumption is useful in two respects: first, it is helpful to know the initial impact of a tax measure before adjustment occurs; second, the nature, extent and speed of behavioral changes are not easily forecast. Yet behavioral changes usually accompany any important tax measure. In the international tax area, not only will multinational firms adjust their dividend distribution rates, investment decisions, and financing policies in response to U.S. tax legislation, but also foreign governments may modify their own tax rules. At least four reactions are possible.

First, foreign subsidiaries might increase their dividend distributions in order to ensure and accelerate recognition of the foreign tax credit for dividend withholding taxes.

Second, the extent of investment in foreign subsidiaries might be curtailed. At the same time, U.S. parent firms might increase their investment in the United States. The financing of foreign subsidiaries might be modified to reduce reliance on intra-firm equity, and increase reliance on intrafirm debt, and more importantly, external debt.

Third, U.S. parent firms might place greater stress on minority participation in new ventures and they might attempt to "decontrol" some existing CFCs.

Four, foreign governments might selectively increase their own taxation of U.S. controlled foreign corporations.

1/ The reason for compulsory use of the overall limitation is to prevent U.S. corporations from offsetting foreign branch losses incurred in some countries against U.S. source income, while claiming a foreign tax credit on foreign source income earned in other countries.

Each of these four reactions would affect the revenue implications of terminating deferral. Some would increase U. S. revenue; others would decrease U. S. revenue. The following paragraphs summarize the possible revenue consequences of these behavioral changes.

(i) Change in distribution rates. U. S. foreign subsidiaries typically distribute approximately 45 percent of their after-foreign-tax earnings. The revenue estimates in Table 7, 8, and 9 are based on this distribution rate. By contrast, Table 10 shows the revenue effect of increasing the distribution rate to 100 percent of foreign after-tax earnings. U. S. revenue gains would be substantially or completely eroded because foreign withholding taxes creditable under Section 901 would be larger. 1/ In fact, if the termination of deferral induced a 100 percent distribution rate, with an overall limitation on the foreign tax credit and worldwide consolidation of foreign subsidiary income, the U. S. revenue loss would be $375 million. Under a per-country limitation, the revenue loss would be $105 million. The revenue losses are calculated by reference to taxes otherwise collected under Subpart F, as expanded by the Tax Reduction Act of 1975. The reason for these revenue losses is that additional foreign withholding taxes would be credited against existing U. S. taxes collected both on Subpart F income and on foreign source dividends, interest, rents, royalties, fees, and branch income.

The revenue losses would be more than proportional to any intermediate increase in dividend distributions from the current rate of about 45 percent to the hypothetical maximum rate of 100 percent. Most of the loss would occur with the first increments in the overall dividend distribution rate, since additional dividends would presumably be distributed first from CFCs paying the highest foreign taxes.

(ii) Foreign vs. domestic investment. Tables 11 and 12 present rough and conflicting estimates of the revenue consequences of changes in investment behavior resulting from the termination of deferral. The revenue estimates in Table 11 are based on Professor Horst's model which attempts to measure the investment and financial position of a multinational firm after it has fully adjusted to the termination of deferral. The model, described in Section 5, assumes that the firm can to some extent choose between foreign and domestic investment, and between alternative means of financing its assets.

The estimates in Table 11 are made from two starting points: the current dividend distribution rate and a 100 percent dividend distribution rate. The dividend distribution rate affects both the division of revenue changes between the United States and foreign governments, and the total amount of these changes.

1/ The same revenue effects would result if foreign governments imposed withholding taxes on deemed distributions of foreign affiliates.

Table 10

Revenue Effect of 100 Percent Dividend Distribution Rate
(Millions of Dollars)

1976 Calendar Year Tax Liabilities	Overall Limitation	Per-country Limitation 2/
Total actual and potential revenue from current taxation of CFC earnings	-125	145
Potential revenue from 100 percent dividend distribution rate 1/	-375	-105
Mining	-5	5
Petroleum and Refining	---	115
Manufacturing	-315	-240
Other	-55	15
Actual revenue from Subpart F, total	250	250
Pre-1975 revenue	25	25
Tax Reduction Act changes	225	225

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1/ The estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) CFC profits and losses are pooled on the same basis as the foreign tax credit limitation; (iii) no behavioral change, except that all CFCs increase their actual dividend distribution rates to 100 percent.

2/ These estimates assume that the per-country limitation is already in place, and that deferral is then ended. The revenue changes refer only to the additional impact of eliminating deferral.

Table 11

Termination of Deferral with Assumed Changes in Investment
Location and Means of Finance
(Millions of Dollars)

	1976 Calendar Year Tax Liability: Current Dividend Distribution Rate	1976 Calendar Year Tax Liability: 100% Dividend Distribution Rate
Total actual and potential U.S. revenue from current taxation of CFC earnings, with specified investment and financing changes 1/	1,000	260
Actual revenue from Subpart F, total	250	250
Potential revenue from termination of deferral with no investment or financing changes	365	-375
Potential revenue from possible changes in investment and financing: 2/	385	385
(1) Effects on foreign source income--		
(a) Decrease in CFC earnings	-15	-15
(b) Decrease in royalties, fees, and interest repatriated to the United States	-10	-10
(2) Effects on domestic source income --		
(a) Increase in domestic investment	90	90
(b) Increase in use of equity capital in the United States and increase in use of external debt abroad	320	320
Addenda: Change in foreign revenue from corporate income and dividend withholding taxes 3/	-210	630
(1) Effect of 100 percent dividend distribution rate on dividend withholding taxes	--	840
(2) Effect of reduced size and increased use of external debt by CFCs on corporate income tax and withholding tax	-210	-210

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1/ The estimates assume: (i) dividends from less developed countries are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) worldwide pooling of CFC profits and losses, and an overall limitation on the foreign tax credit; (iii) specified behavioral changes in dividend distribution rates, investment and financing. The detail underlying these figures appears in Tables 7 and 10.

2/ The estimates represent the revenue impact after full adjustments to the current taxation of CFC earnings, including adjustments to the Tax Reduction Act of 1975. The adjustments would, in fact, take several years. The estimates are adapted from a model developed by Thomas Horst, "American Multinational and the U.S. Economy," American Economic Review, May 1976.

3/ The estimates assume no change in foreign tax laws.

Table 12

Termination of Deferral with Assumed Adverse Impact on Competitive Position of U.S. CFCs
(Millions of Dollars)

	Calendar Year Tax Liabilities	
	1976	1981
Estimated U.S. revenue from corporate taxation of all foreign source income with termination of deferral 1/	2,610	3,200
Estimated U.S. revenue from corporate taxation of all foreign source income under current law 2/	2,245	3,600
Estimated change in U.S. revenue with termination of deferral	365	-400

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1/ The 1976 figure is based on estimated 1976 revenues plus the potential revenue from complete termination of deferral. The 1981 figure is adapted from a model developed by Robert B. Stobaugh, "The U.S. Economy and the Proposed U.S. Income Tax on Unremitted Foreign Earnings of U.S. Controlled Foreign Manufacturing Operations Abroad," Harvard Business School, 1975.

2/ The 1976 figure reflects the Tax Reduction Act of 1975. The 1981 figure assumes an annual growth rate of 10 percent in the foreign source of U.S. corporations.

The potential U.S. revenue gain from changes in the location of investment and the means of finance, after all adjustments have taken place, is very roughly estimated at $385 million whether the dividend distribution rate remains at current levels or increases to 100 percent. The figure of $385 million reflects a revenue loss of about $25 million from smaller CFC earnings and reduced intrafirm payments of interest, rents, royalties, and management fees, and a revenue gain of about $410 million from larger U.S. corporate investment and a shift in the means of finance. Foreign subsidiaries would rely to a greater extent on local debt finance, while U.S. parent corporations would use more equity capital.

These calculations do not take into account possible attempts by foreign governments to offset the shift of investment location and means of finance through modification of their own tax laws.

Under current dividend distribution rates, the model suggests that firms would pay an additional $750 million in U.S. taxes while they would pay $210 million less in foreign taxes. The net increase in corporate tax payments at home and abroad would thus be $540 million. Under a 100 percent dividend distribution rate, the model suggests that firms would pay an additional $10 million in U.S. taxes and an additional $630 million in foreign taxes. The net increase in corporate tax payments at home and abroad would be $640 million under this assumption.

The revenue estimates in Table 12 are based on Professor Stobaugh's model which attempts to measure the long-term consequences of placing U.S. controlled foreign corporations at a competitive disadvantage through the termination of deferral. Again , these calculations do not take into account possible offsetting measures by foreign governments.

The Stobaugh model assumes that higher U.S. taxes on CFCs will, after a period of time, cause a cumulative contraction in their market share, profitability, and the remittance of interest, royalties, and management fees to the U.S. parent corporations. Moreover, CFCs will find it advantageous to distribute a larger share of earnings and rely more heavily on debt finance. 1/ The predicted result is a cumulative reduction in U.S. taxes not only on the foreign earnings of CFCS but also on the associated types of foreign income paid to U.S. parent firms. In 1981, five years after the termination of deferral, the model estimates that U.S. taxes on all foreign source income would be $400 million less than under present law. In succeeding years, the adverse revenue impact would be even larger.

1/ Both the Horst and Stobaugh models envisage a larger role for debt finance if deferral is terminated.

(iii) Minority participation and "decontrol". If deferral is terminated, some multinational firms might seek to minimize the impact of current U. S. taxation either by undertaking new foreign investments through minority ownership in joint venture arrangements or by "decontrolling" some of their existing CFCs. Either way, the retained earnings of the foreign corporation would not be subject to current U. S. taxation. However, decontrol of an existing CFC could entail substantial U. S. taxes on accumulated earnings and profits. Moreover, even if decontrol in the tax sense does not involve the total loss of control, it at least inhibits managerial flexibility, and makes international business decisions more difficult. A new minority ownership arrangement raises similar problems.

While the difficulties associated with decontrol and minority ownership arrangements cannot be quantified, a useful perspective may be gained by comparing the total tax burden on U. S. multinational corporations with and without deferral. In 1976, total U. S. and foreign taxes on foreign source corporate income, other than income earned by the petroleum sector, were approximately $12.3 billion. The complete termination of deferral might increase the tax burden by as much as $0.6 billion, or by 5 percent. 1/ Because this figure is relatively modest, and because the tax costs alone of reorganization are substantial, it seems unlikely that many multinational firms would reorganize their corporate structure as a means of avoiding current U. S. taxation. 2/

Table 13 gives the estimated structure of foreign affiliate earnings classified by the percentage of U. S. ownership in the affiliate. Only 5.2 percent of profits were earned by foreign affiliates owned less than 50 percent by U. S. parent corporations. Even if this percentage doubled or tripled, and even if the growth were concentrated in low-tax countries, the tax avoidance would be modest. If deferral was terminated, and if the proportion of earnings accounted for by non-CFC foreign affiliates subsequently increased to 10 percent, the revenue gain would be reduced by $50 million; at 15 percent, the reduction in revenue gain would be $100 million (Table 14).

The potential revenue loss could be a greater problem if foreign affiliates owned exactly 50 percent by "U. S. shareholders" generally escaped classification as CFCs. Under the Garlock and Kraus decisions, U. S. ownership of exactly 50 percent of a foreign affiliate, coupled with actual U. S. control of the affiliate, might meet the test of Subpart F. The CCA, Inc. case represents a contrary position.

1/ This figure, from Table 7, assumes an overall limitation on the foreign tax credit and includes Subpart F revenue.

2/ J. S. Kramer and G. C. Hufbauer, "Higher U. S. Taxation Could Prompt Changes in Multinational Corporate Structure", International Tax Journal, Summer 1975. But see Forbes, "The Terrible Worry", July 15, 1976, p. 33.

Table 13

Net Earnings by Extent of
U.S. Ownership in Foreign Affiliates
(Millions of Dollars or Percent)

U.S. ownership percentage	1973 net earnings 1/	Percent of net earnings
	BY AREA	
All Areas	17,495	100.0
95-100%	14,290	81.7
50-94%	2,290	13.1
25-49%	584	3.3
10-24%	285	1.6
1-9%	46	0.3
Canada	2,846	100.0
95-100%	1,904	66.9
50-94%	781	27.5
25-49%	93	3.3
10-24%	44	1.6
1-9%	21	0.7
Western Europe	5,957	
95-100%	4,742	79.6
50-94%	815	13.7
25-49%	176	.3.0
10-24%	205	3.4
1-9%	11	0.2
Latin America and other Western Hemisphere	2,628	100.0
95-100%	2,387	90.8
50-94%	185	7.0
25-49%	43	1.7
10-24%	9	0.4
1-9%	4	0.1

Table 13 - continued

U.S. ownership percentage	1973 net earnings 1/	Percent of net earnings
Africa, Asia and Australia	6,065	100.0
95-100%	5,109	84.2
50-94%	514	8.5
25-49%	321	5.3
10-24%	109	1.8
1-9%	7	0.1
	BY INDUSTRY	
Petroleum	6,183	100.0
95-100%	5,475	88.6
50-94%	560	9.1
25-49%	92	1.5
10-24%	29	0.5
1-9%	26	0.4
Manufacturing	7,286	100.0
95-100%	5,668	77.8
50-94%	1,138	15.6
25-49%	300	4.1
10-24%	160	2.2
1-9%	19	0.3
All other industries	4,026	100.0
95-100%	3,145	78.1
50-94%	592	14.7
25-49%	192	4.8
10-24%	26	2.4
1-9%	1	0.0

Office of the Secretary of the Treasury
Office of Tax Analysis

April 6, 1976

Source: Based on Table B-10 of the Preliminary Draft of U.S. Direct Investments Abroad 1966 Part I: Balance of Payments Data (U.S. Department of Commerce, 1970), pp. 83-84; and Table 9 of J. Freidlin and L.A. Lupo, "U.S. Direct Investment Abroad in 1973," Survey of Current Business, (August 1974), Pt. II, pp. 16-17.

1/ Net earnings are after-foreign tax. Foreign affiliates include foreign branches, counted as 100 percent owned by the U.S. parent corporation.

Table 14

Estimated Revenue from Subpart F and Termination of Deferral with Increase of Non-CFC Earnings

	1976 Calendar Year Tax Liability		
	5% of Earnings in non-CFCs	10% of Earnings in non-CFCs	15% of Earnings in non-CFCs
Total actual and potential revenue from current taxation of CFC retained earnings	615	565	515
Actual revenue from subpart F, total	250	250	250
Potential revenue from termination of deferral, total 1/	365	365	365
Change in revenue from new minority participation or decontrol of CFCs 2/	--	-50	-100

Office of the Secretary of the Treasury
Office of Tax Analysis

February 4, 1976

1/ These estimates assume: (i) dividends from less developed country corporations are "grossed up" for purposes of calculating the tentative U.S. tax and the foreign tax credit; (ii) foreign subsidiary losses are fully offset against foreign subsidiary profits and all firms use the overall limitation in calculating the foreign tax credit; (iii) no behavioral change other than the specified changes in non-CFC earnings.

2/ Assumes that incremental non-CFC earnings are taxed by the foreign government at a 20 percent rate, including withholding taxes. Non-CFC earnings are defined as the earnings of those foreign affiliates which are owned less than 50 percent by "U.S. shareholders."

(iv) Higher foreign taxes. If deferral were terminated, foreign governments could selectively increase the tax burden on U.S. controlled foreign corporations in circumstances where the foreign tax rate was lower than the U.S. tax rate. Alternatively, they could raise withholding tax rates and treat deemed dividend distributions as actual dividend distributions for withholding tax purposes. Such changes in foreign tax practices would take time, and would probably not occur as an immediate response to the termination of deferral, but the long-term result of such changes would be lower U.S. tax collections and higher foreign tax collections. The revenue outcome would be similar to the estimates presented in Table 10 for a 100 percent distribution rate. U.S. taxes collected on the retained earnings of foreign subsidiaries would be diminished as a result of higher foreign taxes.

8. Summary of the analysis. Before turning to the policy options, it might be useful to restate the major issues and findings. The debate surrounding deferral has often lacked a clear definition of objectives. The termination of deferral has been urged at different times by different groups seeking at least five different objectives.

(a) To improve tax neutrality;

(b) To eliminate tax avoidance;

(c) To simplify the tax law;

(d) To discourage foreign investment;

(e) To increase U.S. tax revenues.

These different objectives can lead to conflicting policies.

(a) Tax neutrality. The termination of deferral would, of course, be diametrically opposed to the principles of capital-import neutrality. The current taxation of retained CFC earnings is usually urged as a step not toward capital-import neutrality, but rather as a step toward capital-export neutrality. But the termination of deferral would not by itself advance the standard of capital-export neutrality. With the end of deferral, the U.S. tax system would on the whole favor domestic investment even more than it does now. Collateral changes would be required in the investment tax credit, the accelerated depreciation range, DISC, and other tax practices in order to approach capital-export neutrality.

(b) Tax avoidance. In the context of foreign corporate investment, tax avoidance is sometimes very broadly defined to occur whenever the realized foreign tax rate is less than the statutory U.S. rate of 48 percent. If this broad definition is accepted, then the termination of deferral would eliminate virtually all cases of tax avoidance.

However, tax avoidance is often defined more narrowly, either with reference to realized U.S. tax rates or with reference to artificial corporate structures and business arrangements.

When tax avoidance is defined with reference to realized U.S. tax rates, then its extent is much less significant. The investment tax credit, asset depreciation range, DISC, and other domestic tax preferences all serve to reduce the realized U.S. corporate tax rate on domestic income which, in 1974, was about 41 percent.1/ However, the termination of deferral would generally subject CFC income to a tax of 48 percent. Tax avoidance would be more than offset, and in fact, foreign corporate income would generally be taxed at a higher rate than domestic corporate income.

When tax avoidance is defined with reference to artificial corporate structures and business arrangements, then the appropriate solution might involve an extension and strengthening of Subpart F rather than the general termination of deferral. 2/

(c) Tax simplification. It has been argued that the termination of deferral would lead to the simplification of tax law and administration. Subpart F could be repealed, since all CFC income would be taxed currently. Moreover, there would be somewhat less pressure on arm's-length pricing rules (Section 482), on the non-recognition provisions involving transfers of capital, technology, and other property to foreign corporations (Sections 351 and 367), and on reorganizations involving foreign corporations (Section 367).

However, the partial termination of deferral would introduce numerous new complications into the tax code. These complications could include the determination of a minimum percentage distribution and the allocation of a deemed distribution among CFCs in the same group of related corporations (in the case of partial termination), the measurement of subsidiary earnings and profits and taxable income according to U.S. accounting standards, the extent of consolidation of CFCs, and rules to deal with attempted avoidance through decontrol. These complications are discussed in Section 3 of part IV.

(d) Investment and financial impact. Based on one economic model, it has been calculated that the termination of deferral might, over a period of time, cause U.S. corporations to reduce their foreign assets by as much as $3.4 billion, and increase their domestic assets by $2.2 billion (Table 4). These estimates depend on numerous assumptions, and may represent extreme statements of the investment impact. Other models suggest that U.S. corporations would reduce both their U.S. and foreign investment as a result of the termination of deferral. In general, the estimates do not reflect the possibility of adverse foreign reaction.

1/ The realized tax rate figure of 41 percent does not reflect the base broadening meaures contemplated in Table 1. For example, accelerated depreciation and certain reserves (e.g. for bad debt) are not taken into account.

2/ It should be noted that the overall limitation, which permits an averaging of the taxes imposed by high-tax and low-tax countries, can create more potential for tax avoidance than deferral.

In addition to its impact on real investment, the termination of deferral might encourage firms to change their means of finance. Some firms might find it advantageous to substitute borrowing for parent firm equity. The extent of such substitution would depend on a variety of considerations, including tax rules adopted by host countries.

(e) U.S. tax revenue. The effect of terminating deferral on U.S. revenue depends on several factors. Under the standard assumption of no change in corporate or foreign government behavior, the revenue gain could be $365 million (Table 7). Other assumptions suggest lower revenue gains, or even revenue losses. For example, under the assumptions that all CFC earnings would be actually distributed following the termination of deferral, the U.S. loss could be $375 million (Table 10).

IV. OPTIONS

Legislative options on deferral can be grouped into four broad categories: (1) retain the present system; (2) broaden Subpart F to include more types of income; (3) partly or completely terminate deferral by requiring that deemed and actual distributions equal some portion or all of CFC earnings; and (4) terminate deferral in the context either of providing a special statutory deduction for foreign source income or of repealing domestic tax preferences. Option (3) involves secondary questions as to the extent of consolidation between subsidiaries, and the choice of exclusively using the overall limitation on the foreign tax credit, or reinstating the per-country limitation as the exclusive method.

1. Retain present system. It can be argued that no further legislation is needed on the deferral issue. The Tax Reduction Act of 1975 substantially extended Subpart F, and as a result the principal areas of tax abuse have been closed off. Further legislative restrictions could prove counter-productive by accelerating actual distributions, triggering legislative reactions abroad, reducing the profitability and growth of American firms, adding complexity to the Internal Revenue Code and placing undue administrative demands on the Internal Revenue Service. Moreover, while the present tax system favors foreign investment in some cases, it favors domestic investment in many other cases.

2. Broaden Subpart F. Subpart F could be broadened in several respects, consistent with its objective of reaching foreign income with tax abuse characteristics.

(a) The substantial reduction test. Under Section 954 (b)(4), a CFC that does not have as one of its significant purposes a substantial reduction of taxes is generally excluded from Subpart F. 1/ This exemption underscores the anti-tax avoidance purpose of the statute, but it has been drafted in a manner that limits the application of Subpart F. The test is basically whether the effective tax rate paid by the foreign corporation equals or exceeds 90 percent of, or is not less than 5 percentage points lower than, the effective foreign tax rate that would have been paid if the income had not passed through a foreign base company (Regulations 1.954-3(b)(4), example (1)). Certain foreign countries impose low rates of tax, while others exclude certain kinds of income from taxation altogether. Therefore, the CFC can meet the 90 percent or the 5 percentage point test, yet still be paying far less than the U.S. corporate tax rate of 48 percent. Moreover, the test poses substantial administrative difficulties, because it requires the Internal Revenue Service agent to have an intimate knowledge of third country tax laws.

1/ Particular items of income may still be taxed under Subpart F if the transaction was structured to avoid taxes.

This difficulty could be eliminated in the context of Subpart F by recasting the "substantial reduction" test to refer not to alternative foreign tax rates, but to the U.S. corporate tax rate. If the present "substantial reduction" test obstructs the revenue gains projected under Subpart F as expanded by the Tax Reduction Act of 1975, then very large amounts of revenue could depend on an appropriate modification, perhaps as much as $100 million. However, this amount is not additional to, but rather a part of, the revenue collections already estimated for Subpart F.

(b) 50 percent subsidiaries. The present language of Subpart F appears to exclude foreign corporations that are owned exactly 50 percent by U.S. shareholders. However, the Tax Court has found that 50 percent ownership, combined with actual control, will suffice for Subpart F purposes. The statute could be strengthened to avoid the CCA, Inc. decision by including foreign subsidiaries owned exactly 50 percent by U.S. shareholders, with a rebuttable presumption of actual control. The revenue consequences of this change are estimated at less than $5 million.

(c) Shipping income. The Tax Reduction Act of 1975 included international shipping income under Subpart F, to the extent it is not reinvested in shipping operations. However, the earnings of most shipping companies are likely to come within the reinvestment exclusion. Subpart F could be broadened to include all shipping income, whether or not reinvested. Such a provision should be related to other changes in the taxation of shipping income discussed elsewhere in this volume. The potential revenue gains are estimated at $70 million.

(d) "Runaway plants" and tax holiday manufacturing. In 1973, the Treasury proposed that tax haven manufacturing corporations, defined to include "runaway plants" and tax holiday operations, should be taxed currently under provisions similar to Subpart F.

A runaway plant would be defined as new investment in a controlled foreign corporation which realized more than 25 percent of its gross receipts from the manufacture and sale of products to the United States, and paid a foreign effective tax rate of less than 80 percent of the U.S. corporate tax rate. A tax holiday manufacturing corporation would be defined as any controlled foreign corporation which increased its investment in excess of 20 percent during or in anticipation of a foreign tax incentive. Foreign tax incentives would be broadly defined under regulations prescribed by the Secretary of the Treasury. The tax haven manufacturing proposal would increase revenue by about $25 million.

(e) Simplification. Although Subpart F was based on the earlier foreign personal holding company statute, no effort was made to combine the two pieces of legislation or to enact identical statutory tests to define the controlling group or constructive ownership. Section 951(d) attempts to coordinate Subpart F with the foreign personal holding company provisions. However, the method of coordination can lead to complexity and can make it advantageous to become a foreign personal holding company as means of avoiding Subpart F. In addition the line of demarcation between deemed distributions and the penalty tax on personal holding companies is not clear.

These statutes could be simplified by taxing foreign personal holding companies solely within the framework of Subpart F, and by establishing a clear boundary between deemed distributions and the penalty tax on personal holding companies. The revenue effect would be small.

3. Partial or complete termination of deferral. Some observers contend that the separate entity system of taxing foreign corporations reduces U.S. tax revenue and encourages foreign investment at the expense of domestic investment. These observers argue that the remedy lies in the partial or complete termination of deferral.

Other observers point out that the termination of deferral might produce only short-run revenue gains, and that, as an isolated step, it would move the United States further away from a system of capital-export neutrality. Moreover, adverse foreign reaction could be intense, especially from countries such as Israel, Egypt, and Ireland which promote industrial development through tax relief.

The complete termination of deferral would clearly replace Subpart F, but the partial termination of deferral would not serve the same function, since Subpart F provides for current taxation of all CFC income in selected situations. Partial termination legislation would need to be carefully coordinated with existing Subpart F to avoid overlapping coverage that could cause very severe administrative problems for taxpayers and the Internal Revenue Service. In any event, partial termination would require very complex legislation.

The revenue estimates for the complete termination of deferral under the standard assumption of no behavioral changes range from \$365 million to \$630 million depending on whether an overall or per-country limitation is used for the foreign tax credit (see Table 8). If allowance is made for behavioral change, the revenue gains would be less, and there might even be a revenue loss of up to \$375 million from the termination of deferral (see Table 10). The partial termination of deferral would involve both smaller revenue gains (under the standard assumption) and smaller revenue losses (under the worst case assumption).

The partial or complete termination of deferral involves several choices as to coverage and mechanics. The important choices are outlined in the following paragraphs.

(a) Required minimum percentage distribution. The partial termination of deferral would involve a percentage test for the distribution of earnings and profits. To the extent actual distributions do not meet the minimum percentage, earnings would be distributed on a deemed basis. The percentage could be based on after-tax earnings and profits, or on after-tax earnings and profits plus other categories of foreign source income, such as interest, royalties, management fees and branch earnings. The broader the base amount, the easier it is to meet the test, as illustrated by Table 8.

(b) Allocation of the deemed distribution between CFCs. The partial termination of deferral would also involve allocation of the deemed distribution between CFCs. This allocation is needed both to trace the foreign tax credit associated with each deemed distribution and to maintain an inventory of deemed distributions for each CFC. The allocation could be made on a pro rata basis with respect to the undistributed earnings of all CFCs, or the allocation could be made only with respect to the CFCs not meeting the minimum percentage. The allocation rule should be consistent with the consolidation rule.

(c) The extent of consolidation. In the case of partial termination, the question arises whether the minimum percentage applies to each CFC individually, or to a U.S. parent corporation's CFCs grouped on a country, on a worldwide, or on some other basis. In the case of complete termination, the extent of consolidation is also important. The wider the grouping, the smaller the revenue impact of any given percentage test, as shown in Table 8. This relationship reflects two phenomena: first, some CFCs have losses, and these losses increase the apparent distribution rate of profitable CFCs; second, CFCs with high foreign taxes already tend to distribute a larger percentage of earnings than CFCs with low foreign taxes, and if high-tax CFCs are consolidated with low-tax CFCs, the average creditable foreign tax is increased. There are several possible consolidation alternatives.

(i) Individual foreign corporation approach. This approach would employ the present Subpart F mechanism of computing the income to be deemed distributed separately for each foreign corporation. There would be no consolidation of foreign corporations either with other foreign corporations owned by the same U.S. parent, or with the U.S. parent itself. Losses and blocked currency already create problems under this system, and these problems would become more important if deferral were eliminated. Under the individual foreign corporation approach, there are two methods for computing the amount of income of a lower-tier subsidiary which is included in the income of the U.S. shareholders: the so-called "hopscotch" method; and the so-called "link-by-link" method.

(aa) Hop-scotch method. This is the mechanism by which Subpart F presently attributes the income of a lower-tier CFC to its shareholders. Under this method, the income is attributed directly to the U.S. shareholders, and cannot be offset by any loss incurred by intermediate foreign corporations. Under this method there are problems concerning the source country of a deemed distribution. In addition, if the intermediate corporation is in a country which restricts the repatriation of earnings, there can be blocked currency problems.

Compulsory adoption of the overall limitation for the foreign tax credit renders the source problem almost moot.1' However, if the per-country limitation is restored, it would be necessary to establish a source rule for the deemed dividend. Under present law, actual dividends are sourced in the country of incorporation of the subsidiary paying the dividend to the U. S. shareholder. Thus, if lower-tier CFC A distributes dividends to higher-tier CFC B, which in turn distributes dividends to the U. S. parent corporation, the dividends are sourced in country B. A rule more in keeping with the intent of the per-country limitation would require that dividends be sourced in the country of incorporation of the lower-tier subsidiary which earns the income.

Blocked currency creates a problem under Subpart F, and the problem would continue if the hop-scotch method were used more widely. The problem here is the effect on the lower-tier corporation if the intermediate corporation's country of residence restricts distributions so that the lower-tier corporation cannot distribute up the chain of ownership. Thus, the U. S. shareholder might be taxed on income which he could never realize. One solution is to apply the present blocked currency rules as if the country of incorporation of the lower-tier subsidiary restricts the repatriation.

(bb) Link-by-link method. The link-by-link method was considered by the Treasury in 1962. It was rejected partly because its complexity was not justified in light of the limited goals of Subpart F as then enacted. The question now is whether the complete or partial termination of deferral, with its impact on all foreign corporations controlled by U. S. persons, would justify reconsideration of the link-by-link approach.

Under the link-by-link method, the retained earnings of a lower-tier subsidiary would be constructively distributed up the chain of ownership. The profits of a lower-tier subsidiary would thus offset the losses of a higher-tier subsidiary in the same chain. However, there would be no offset of losses in the lower-tier by profits in the higher-tier, nor would there be offsets as between different chains of CFCs owned by the same U. S. parent.

1' A problem can still arise for a CFC with U. S. source income or, during the transition period, for a U. S. parent corporation which owns a possessions corporation or a mining company.

If the per-country limitation of the foreign tax credit is reinstated and the present income source rules are not changed, the source of the deemed distribution would be the country of incorporation of the first-tier corporation. Again, this result would circumvent the purpose of reinstating the per-country limitation, and suggests a reconsideration of the source rules.

If the link-by-link approach is adopted, the computation of earnings and profits must be correspondingly altered. If the constructive distribution is treated as an actual distribution, the earnings and profits of the lower-tier foreign corporation should be reduced by the amount of the constructive distribution, and the earnings and profits of the foreign corporation next in the chain should be correspondingly increased. This process should continue up the chain to the domestic parent. Thus each controlled foreign corporation would keep two sets of accounts: one set would reflect actual distributions while the other set would reflect deemed distributions for U. S. tax purposes. These two sets of books are presently kept for CFCs subject to Subpart F.

(ii) Consolidation of foreign operations. Under this method, all foreign corporations within a controlled group would file a consolidated return in a manner similar to that currently available for domestic corporations. The consolidated return would presumably reflect only the U. S. parent corporation's share of the earnings and profits of its CFCs. If the consolidated return showed an overall profit on foreign operations, the U. S. parent corporation would receive a deemed distribution of the foreign profit. If the consolidated return showed an overall loss, the parent might be allowed to claim the loss as a deduction against domestic income, or at least carry over the loss against future foreign profits. The purpose of a rule limiting the deductibility of overall foreign losses would be to protect the U. S. tax base.

Which foreign corporations would be allowed (or required) to consolidate? Consolidation should probably be limited to foreign corporations which are members of the same affiliated group, as that term is defined in Section 1504(a). However, consideration might be given to lowering the required ownership to 50 percent from 80 percent, so that most controlled foreign corporations would be includable in the consolidated return, or even to 10 percent so that all CFCs would be includable.

Consolidation could be required, or it could be provided as an elective alternative to computation of income on an individual foreign corporation basis. If an election is provided, it would seem best to make it binding for future years, revocable only with the consent of the Commissioner. Standards for allowing revocation could be included in the legislative history or in the statute.

Blocked currency would raise problems. If one of the foreign corporations in the affiliated group is prevented by its home country from making a distribution, what is the effect on the group? Should that corporation be excluded from the group, or should it be assumed that the rest of the group will be able to distribute enough to make up the difference? A percentage test might be appropriate so that, if the income of the blocked currency corporation is less than a fixed percentage of the income of the group (for example, 10 percent), then that corporation will be consolidated; otherwise it will be excluded.

(iii) Consolidation of worldwide operations. Under this approach the controlled group of corporations would file a single U.S. tax return for its worldwide operations rather than separate returns for domestic and foreign activities.

The questions concerning which corporations are to be included, an elective as opposed to a mandatory system, and blocked currency exist here as with the consolidated foreign operations approach. Additional questions arise. Should an electing corporation still be treated as a foreign corporation for purposes of Section 367? Arguably not, because most tax avoidance potential is gone. On the other hand, high overall foreign tax rates might make it advantageous to transfer income producing assets from the United States to tax havens. Worldwide consolidation clearly raises several difficult issues.

(d) The problem of decontrol. The partial or complete termination of deferral could encourage firms to decontrol their existing CFCs and to take minority positions in new joint ventures as a means of avoiding U.S. taxation.

If decontrol and minority positions are a matter of concern, the foreign tax credit for deemed paid taxes (Section 902) might be limited to those U.S. shareholders claiming "actual control" of the foreign corporation (alone or acting in concert with other U.S. taxpayers), and thus presumptively subject to current taxation of earnings retained by the foreign corporation. Minority U.S. shareholders in a foreign corporation could thus elect either current taxation coupled with the deemed paid credit, or deferral without the deemed paid credit. 1/ Under present law, the deemed paid credit is not available for passive portfolio investments, generally defined as investments where U.S. corporate shareholders have less than 10 percent ownership or investments by individuals. The rationale of the deemed paid credit is to avoid double taxation when a U.S. corporation has an active management stake in the foreign investments. An explicit link between "actual

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1/ In both alternatives, a credit for direct foreign taxes, for example withholding taxes on dividends, would still be available under Section 901.

control" and the deemed paid credit would bring the basic purpose of Section 902 into sharper focus. The estimated amount of deemed paid foreign tax credit claimed in 1976 for foreign corporations owned less than 50 percent by U. S. shareholders is about $250 million. It is uncertain how much of this amount would be claimed under an "actual control" election, and it is very difficult to predict the potential extent of decontrol following the termination of deferral.

4. Terminate deferral in the context of a special statutory deduction or the repeal of domestic tax preferences. As Table I indicates, the termination of deferral as an isolated measure would move the U. S tax system further away from a standard of capital-export neutrality for the non-extractive industries.1/ The partial or complete termination of deferral, by itself, would favor manufacturing and other nonextractive investment in the United States by comparison with investment abroad. If tax neutrality between domestic and foreign investment is the goal, then deferral should be changed only in the context of a broader program. Specifically, the termination of deferral should be accompanied by collateral tax changes.

It is often assumed that termination of deferral would necessarily imply the taxation of undistributed earnings at the U. S. corporate rate of 48 percent. The average realized tax rate for U. S. industry as a whole is closer to 41 percent than 48 percent . Thus, if undistributed earnings of foreign subsidiaries were taxed at the nominal 48 percent rate, foreign investment income would bear a much heavier average tax burden than domestic investment income.

One solution would involve imposition of a lower nominal U. S. corporate rate on foreign income. The lower nominal rate could be established either by statute or, more flexibly, by the Secretary of the Treasury, with reference to the average realized corporate tax rate on domestic investment. From a mechanical standpoint, a lower nominal rate could most easily be implemented by a special statutory deduction equal to a percentage of foreign source income. In structure, the deduction would be comparable to the Western Hemisphere Trade Corporation deduction. For example, a statutory deduction equal to 16. 7 percent of foreign source income would convert a nominal corporate rate of 48 percent into a realized corporate rate of 40 percent. While the special statutory deduction could be restricted to undistributed earnings, logic suggests that it be extended to all corporate foreign source income.

1/ This is true whether capital-export neutrality is defined by reference to present U. S taxation of corporate income, or by reference to U. S. taxation of corporate income in the absence of domestic tax preferences.

Other changes would be appropriately coupled with the concept of a special statutory deduction. Some of these changes were enacted in the Tax Reform Act of 1976, namely, elimination of the Western Hemisphere Trade Corporation (+ $20 million), and inclusion of less developed country corporations in the gross-up requirements (+ $55 million). In addition, provision should be made for a deduction rather than credit for foreign taxes comparable to state taxes (+ $450 million).

The net decrease in tax revenues from non-extractive industries under a system designed to achieve capital-export neutrality in this manner could reach approximately $1.2 billion.1/

Instead of a special statutory deduction, the termination of deferral might be coupled with the general repeal of corporate tax preferences and base-narrowing provisions, and a simultaneous reduction in the nominal corporate tax rate to approximately 33 percent. The net revenue loss of such an approach as applied to foreign source income would be approximately $3.0 billion (Table 1). Extensive international tax cooperation would be required to achieve a reasonable division of the revenue loss resulting from such a fundamental change in tax practices. It would not be reasonable for the United States alone to absorb the entire revenue loss. On the other hand, the United States could not increase its own revenues through the termination of deferral and reasonably expect other countries to undertake all the revenue losing changes required to achieve a system of international tax neutrality.

1/ This figure is calculated in reference to present U.S. taxation of domestic corporate income. See the first column of Table 1. It is assumed that the special statutory deduction would be calculated to have approximately the same effect as extension of the investment tax credit, ADR, and DISC to foreign investment. Thus, the special statutory deduction would entail a net revenue loss of approximately $1.2 billion (Table 1), implying a deduction of about 16 percent of 1976 non-extractive foreign source income of $24.9 billion (Table 1) offset by the repeal of certain preferences. The allowable foreign tax credit would not be affected by the special deduction.

TAX TREATMENT OF INCOME FROM INTERNATIONAL SHIPPING

Marcia Field

and

Richard Gordon

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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 amended or repealed. 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 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.

1/ See Internal Revenue Code Sections 872(b)(1) and (2) and 883(a)(1) and (2). These sections also provide reciprocal exemption for foreign airlines, a topic 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.

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, 1975-2 C.B. 289). 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) 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 explained 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. Consequently the question of whether payments received by an owner for bareboat charter leasing will be eligible for the Section 883 exclusion will depend on the facts and circumstances of each case. 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 rule published by the Treasury seemed to provide 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. 280 (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.

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 good 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 circumstances for exports are very different from the supply and demand circumstances 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 virtual 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 (as under present law) not only by the United States but also by foreign ports of call. This additional taxation might somewhat diminish the attractiveness of the U.S. flag and thus the employment of U.S. crews. If other countries continued to grant exemption on the basis of reciprocity, some ships would find it attractive to move from U.S. registry to registry in a country where reciprocal exemption was still available.

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 more accurately be 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.

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

Table 1

Principal Countries of Registry of Merchant Fleets
as of December 31, 1975
(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	333,042	100.0%	163,731	100.0%
Liberia	70,139	21.1	45,227	27.6
Japan	37,164	11.2	18,640	11.4
United Kingdom	33,229	10.0	18,252	11.1
Norway	27,167	8.2	15,207	9.3
Greece	22,598	6.8	8,604	5.3
U.S.S.R.	14,292	4.3	4,080	2.5
U.S.A. 1/	12,301	3.7	5,432	3.3
Panama	13,743	4.1	5,815	3.6
All Other	102,409	30.7	42,474	25.9

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1/ Includes 2 million tons of government-owned reserve fleet, of which 111,000 tons are tankers.

Source: U.S. Department of Commerce, Maritime Administration, Merchant Fleets of the World, September 1976.

Table 2

U.S. Foreign Trade Transported Under Foreign Flags
1974

	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 1/	587,720	93.5	37,381	70.6	276,609	98.3	273,730	93.0

	Total		Liner		Iregular		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 1/	102,179	82.2	44,213	69.4	33,767	97.7	24,199	93.1

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1/ Preliminary Data

Source: U.S. Department of Commerce, Maritime Administration, Statistics Branch, Division of Trade Studies and Statistics.

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 is treated as having a U.S. source, and all income derived from the high seas is regarded as 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. 2/

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 an election to compute their tax on presumed net income, calculated as a flat

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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.

2/ 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.

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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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.

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	
Denmark	De facto exemption (examples)
Egypt 2/	
Finland	Bahamas
France	Bermuda
Gambia 1/	Liberia
Germany	
Iceland	Not exempt (examples)
Ireland	
Israel 2/	India
Italy	Indonesia
Jamaica 1/	Malaysia
Japan	Philippines
Korea 2/	Singapore
Luxembourg	Venezuela
Malawi 1/	
Netherlands	
Netherlands Antilles 1/	
New Zealand	
Nigeria 1/	
Norway	
Pakistan	
Poland	
Romania	
Rwanda 1/	
Sierra Leone 1/	
South Africa	
Sweden	
Switzerland	
Trinidad and Tobago	
United Kingdom	
U.S.S.R.	
Zaire 1/	
Zambia 1/	

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1/ By extension of another treaty (U.K., Belgian, or the Netherlands).
2/ Not yet approved by the U.S. Senate for ratification.
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) Columbia (1961), Argentina (1950), and Panama (1941).

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 on average.

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 income, equal to the ratio between U.S. gross receipts on shipments to (or from) the 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 initiated 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 require concessions on unrelated issues.

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.

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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Source: Tax Forms 2952

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 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 effective 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 Cyprus and Singapore, respectively.

In contrast, although France and the Netherlands exempt most foreign source income from taxation, they may 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 specifies that France may tax, is that French shipping companies are subject to tax on their foreign source income from the countries with which France has a treaty reserving to France the right to tax French ship and aircraft companies. It is not clear how France determines taxable income in such cases.

Table 6

Taxation of Income from International Shipping in Selected Countries, 1976

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 permanent establishment 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	--	--	--	--	--

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Sources: Submission by various countries: Harvard University, World Tax Series, various volumes; various issues of the Price Waterhouse Information Guides; 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/ "Yes" signifies that tax is imposed only if 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/ U.S.S.R. vessels are 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 27.5/15 rate with no foreign tax credit. The rates are the rates prevailing before the German corporate tax reform of 1976. The portion considered domestic source is taxable at the ordinary 51/15 rate. Alternatively, the taxpayer may elect to be taxed at the ordinary rate on the full amount and claim a foreign tax credit.

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.

Germany presumes that one half of the income of domestic companies from international shipping has a domestic source and that one half 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 liberal 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 flag shippers from fleeing to flags of convenience by giving tax benefits and direct subsidies. The United Kingdom, unlike the United States, permits the use of foreign crews on its flag 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 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 in the table which also unilaterally impose tax on foreign flag ships in the absence of a formal tax treaty

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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.

(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 who are not eligible for the exemption. 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 have a 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 repeal of the present reciprocal exemption would raise the cost of ocean freight and, if such legislation overrode tax treaties, would 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 income 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 would have to 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). The dual test would make 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 would have 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 continued to enjoy reciprocal exemption. These disadvantages could be largely overcome by additional changes along the lines indicated below:

(a) Change the source rules 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) Levy the tax 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, with the election to 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) Require the operator in certain cases 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) Grant reciprocal exemptions 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 beneficial 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) Change Subpart F 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 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.

The Task Force on Foreign Income of the Ways and Means Committee considered the taxation of international shipping income as part of its agenda early in 1976. The Task Force decided to recommend certain changes, as outlined by its Chairman, Representative Rostenkowski, in a speech to the Chicago Council on Foreign Relations on March 29, 1976:

> In trying to achieve these goals, the Task Force is seriously considering a proposal along the following general lines:
>
> A limitation would be placed on the so-called "statutory reciprocal exemption" in the Internal Revenue Code which allows ships coming into the United States to avoid paying U.S. tax if the country in which the ship is registered does not tax U.S. ships traveling to that country. This reciprocal exemption would be extended only to those ships which are engaged in the domestic or foreign commerce of the country under whose laws the ship is registered and to ships owned, in fact, by nationals of that country. This change in the reciprocal exemption would not, however, override existing U.S. tax treaties, which generally provide for a complete exemption of shipping income between the two treaty countries. Instead the Treasury Department would be requested to reexamine the treaties and, where necessary, renegotiate them on a basis similar to the modified statutory exemption.

The Task Force may also propose both a change in the source rules and the taxation of net income at ordinary rates or, in certain cases, a tax on presumptive net income, along the lines described above.

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 U.S. Source Income of Foreign Flag Ships
(Millions of Dollars)

	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	975	98	49
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						100 3/
On flags exempt by statute						80
On flags taxable under present rules 2/						20

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1/ The inbound figures are rounded to the nearest \$50 million; the outbound are available only to the nearest \$100 million.

2/ The tax now collected is estimated at about \$2 million.

3/ Assuming no foreign tax credits from other income.

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 could be accomplished by amending the Internal Revenue Code so that profits of international shipping operations 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 of 1975 is adequate, or whether shipping should be included under Subpart F in full.

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 includes foreign base company shipping income except to the extent reinvested in foreign base company shipping operations. (The Tax Reform Act of 1976 provides that income from shipping operations within one country is not base company shipping income if the ships are registered within that country and the company is incorporated locally.) 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 December 31, 1974, there were 706 U.S. owned foreign flag ships, totalling 27 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. Ships which engage exclusively in commerce between third countries are not eligible for U.S. subsidies. But tax exemption provides an added attraction. In the past it has been particularly attractive for integrated companies which could shelter some profits from other activities in tax haven shipping subsidiaries, using excess foreign tax credits on other income 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). However, the Tax Reduction Act of 1975 and the Tax Reform Act of 1976 set special limits on the credit which may be claimed for foreign taxes paid on oil and gas extraction income; as of 1977 the foreign tax credit for such taxes is limited to 48 percent of foreign oil and gas extraction income.

2. Modifications to Subpart F in 1975. Under the Tax Reduction Act of 1975, shipping profits are 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.

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 December 31, 1974

S U M M A R Y

Country of Registry	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	706	27,551,941	52,776,925	508	23,976,373	46,355,732	86	402,378	400,659	112	3,173,190	6,020,534
Liberia	339	15,978,413	31,882,734	240	13,172,661	26,477,539	10	62,146	73,246	89	2,743,606	5,331,949
United Kingdom	122	4,410,591	8,151,572	74	4,098,941	7,747,887	39	141,897	147,574	9	169,753	256,111
Panama	106	2,402,495	4,249,219	88	2,280,909	4,088,942	12	54,590	48,280	6	66,996	111,997
France	11	1,196,653	2,334,899	11	1,196,653	2,334,899	-	-	-	-	-	-
Netherlands	26	843,040	1,504,204	14	770,787	1,432,533	12	72,253	71,671	-	-	-
Germany (West)	12	651,769	1,227,045	12	651,769	1,227,045	-	-	-	-	-	-
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	10	200,889	324,393	9	163,159	259,393	-	-	-	1	37,730	65,000
Argentina	11	169,791	258,183	6	96,037	141,921	-	-	-	5	73,754	116,262
Denmark	8	136,461	235,649	8	136,461	235,649	-	-	-	-	-	-
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	111,052	1	59,267	111,052	-	-	-	-	-	-
Canada	7	66,481	101,244	7	66,481	101,244	-	-	-	-	-	-
Uruguay	2	50,766	85,830	2	50,766	85,830	-	-	-	-	-	-
Honduras	10	53,494	49.916	-	-	-	10	53,494	49,916	-	-	-
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	-	-	-	-	-	-

Source: U.S. Department of Commerce, Maritime Administration, Foreign Flag Merchant Ships Owned by U.S. Parent Companies, October 1975.

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 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.

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. It is not clear that current taxation under Subpart F would provoke substantial sales, although it might result in some changes in country of registry. For some U.S. owners, shipping is an important part of an integrated enterprise which would not readily be disposed of. Moreover, both the Maritime Administration and the Defense Department have expressed doubts about the usefulness of the "Effective U.S.

1/ Proposed regulations were published in the Federal Register on August 7, 1976; as reprinted in the Commerce Clearing House Standard Federal Tax Reporter they take up 36 pages of single spaced print.

2/ Of course in a prolonged shipping recession, the profits of foreign shipping companies might be modest or nonexistent, so that current U.S. taxation under Subpart F would result in little additional burden.

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. Control of such ships is especially difficult when they engage primarily or exclusively in third country commerce and have virtually no contact with the United States. This is probably 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 doubtful that the sale of some of the U.S. controlled foreign flag ships would have a serious adverse effect 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.

To effectively bring foreign shipping income within the purview of Subpart F it would be important to clarify the applicable rules for determining when the foreign corporation is considered not to have been formed or availed of for the substantial reduction of taxes. The rules applicable to foreign base company service income in this respect would raise serious administrative problems in the case of shipping income, since they refer to the effective foreign tax rates where the services are performed, and might well be ineffective since many countries impose little tax on their shipping companies and no tax is attributable to income generated on the high seas.

In addition, if the deferral of U.S. tax on the undistributed profits of foreign shipping companies were eliminated and the statutory reciprocal exemption of Section 883 were repealed, it would be necessary to avoid double taxation of the same income. Section 952(b) achieves this result for Subpart F income by defining it as excluding income effectively connected with a U.S. trade or business unless U.S. tax is reduced or waived by treaty.

X. OPTIONS

1. Retain present law. This option could be supported on the grounds that the treatment of shipping income under Subpart F was just changed and that any further changes should be delayed long enough to see the results of the earlier legislation. But the 1975 and 1976 changes are not satisfactory. The Tax Reduction Act of 1975 and the Tax Reform Act of 1976 put 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 provisions promises to be extremely complicated.

2. Remove shipping income from Subpart F. This option would return to the pre-1976 situation, which permitted the use of tax haven companies by U.S. ship owners, contrary 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 the foreign effective rates where the services are performed as the standard is extremely complex and leaves much to the discretion of the taxpayer.

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 $240 million. However, an estimated $40 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 $200 million. This figure does not take into account the availability of excess foreign tax credits on other foreign income.

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 of eliminating deferral for shipping CFCs would be about $240 million after foreign tax credits assuming no usable excess credits. This assumes that all of the profits qualified for the exception from Subpart F provided by the Tax Reduction Act of 1975 (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 1976 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 $40 million. Thus, excluding that income from Subpart F would reduce the net revenue gain of eliminating deferral to $200 million (Table 10).

Table 9

Earnings and Profits, Foreign Taxes and Dividends Paid, Selected CFCs Engaged in Shipping, 1973

	Pre-tax Earnings & profits ($ millions)	Foreign Tax Paid		After Tax E&P ($ millions)	Dividends Paid	
		($ millions)	Percent of pre-tax E&P		($ millions)	Percent of after tax 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

July 17, 1975

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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.

Table 10

Estimated Revenue Effect of Eliminating Deferral on the Income of Shipping CFCs
(Millions of Dollars)

	Gross tonnage of ships (thousand tons)	Undistributed pre-tax earnings and profits 2/	Tentative U.S. tax	Foreign tax credit	Revenue gain 4/
Sample of U.S. owned foreign flag ships	17,771	427	205	18	187
Owned by oil companies	15,755	399	192	18	174
Owned by others	1,936	28	13	*	13
Estimated others	6,834	120 3/	58	4	54
Estimated total	24,605 1/	527	253	21	240
Less credit for tax on U.S. source income					40 5/
Net revenue gain					200

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December 1976

1/ As of December 31, 1974. Reported in U.S. Department of Commerce, Maritime Administration, Foreign Flag Merchant Ships Owned by U.S. Parent Companies, October 1975. Excludes ships owned by individuals.

2/ Based on 1973 tax return data. Assumed generally in line with 1976 magnitudes given the slow tanker market in 1975/76.

3/ Estimate based on estimated profits per gross ton and estimated foreign tax and dividend ratios.

4/ This is a maximum estimate; it assumes no usable excess foreign tax credits and makes no allowance for the various escape mechanisms of Subpart F.

5/ Assumes that 20% of the tankers and 50% of the other ships engage in U.S. trade, that those ships derive 75% of their profits from such trade and that U.S. tax at 48% is imposed on 50% of the profits from traffic to and from the U.S.

Source: 1973 tax return data for shipping CFCs and estimates explained above.

U. S. TAXATION OF FOREIGN EARNED INCOME OF PRIVATE EMPLOYEES

Marcia Field

and

Brian Gregg

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I. ISSUE

The issue is whether Section 911, the foreign earned income exclusion, of the Internal Revenue Code should be eliminated, and the currently excluded income made fully taxable. The Section 911 exclusion is a departure from the general rule that U.S. citizens, whether or not resident in the United States, are subject to U.S. tax on their global income.

Prior to the passage of the Tax Reform Act of 1976, Section 911 of the Internal Revenue Code provided that U.S. citizens who remained outside the United States for prolonged periods, other than as U.S. Government employees, excluded from their gross income \$20,000 or \$25,000 annually of their foreign earned income. The Tax Reform Act of 1976 reduced the amount of excludable income and modified the computation of tax on non-excluded income. The excludable amount is reduced to \$15,000 in general. A \$20,000 exclusion is provided for employees of U.S. tax-exempt organizations described in Section 501(c)(3) of the Internal Revenue Code. The applicable U.S. tax on income in excess of the excludable amount is calculated as if there were no exclusion; foreign taxes paid on excluded income are not allowed as a credit; and income received outside the country where it is earned, in order to avoid tax in that country, is not eligible for the exclusion. The Tax Reform Act of 1976 also extended the right to claim a foreign tax credit to taxpayers who use the standard deduction.

II. PRESENT LAW

1. Explanation. Section 911 of the Internal Revenue Code excludes from gross income, and therefore exempts from tax, $15,000 of annual income from foreign employment of U. S. citizens who remain in a foreign country or countries for 17 months (510 days) in any consecutive 18 month period (the "physical presence" rule) or who are *bona fide* foreign residents and have been for at least one full taxable year. The excluded amount is $20,000 for employees of U. S. organizations which qualify as tax exempt organizations under Section 501 (c)(3) of the Internal Revenue Code.

Computing the 510 day period becomes complicated when partial tax years and travel over international waters or air space are involved, especially since the 18 month periods can be overlapping. *Bona fide* foreign residence is determined on the facts and circumstances of each case in terms of indications, such as ties with the local community, or intent to maintain one's permanent home in that country.

The exclusion is not available to U. S. Government employees. Although restricted to U. S. citizens by statute, it is extended by the nondiscrimination clause of income tax conventions to resident aliens who are citizens of certain other countries. 1/

The exclusion is limited to "earned income" which means compensation for personal services actually rendered. Taxpayers who combine labor and capital in an unincorporated business may exclude up to 30 percent of their income from the business as representing compensation for personal services. Income is considered earned in the year the services were performed. Amounts received as a pension or annuity are not excludable, except to the extent that they represent employer contributions made before 1963 or with respect to services performed before 1963.

The excluded amount is taken into account in determining the tax on other income. Under this method, often referred to as "exemption with progression", if $15,000 of income is excludable and $35,000 not excludable, the tax liability is the difference between the tax on $50,000 and the tax on $15,000.

1/ Rev. Rul. 72-330 and 72-598 (1972-2 C. B. 444 and 451).

No deductions properly chargeable against the excluded income may be taken against other income. For example, to the extent that moving expenses or travel and entertainment expenses associated with the foreign employment are not fully reimbursed by the employer, they may not be deducted from other income.

Foreign taxes paid on excluded income may not be deducted in determining taxable U. S. income, nor are these taxes allowed as a foreign tax credit against U. S. tax on foreign source income. Taxpayers eligible under Section 911 may make a permanent election not to claim the exclusion.

2. Legislative history. When introduced in 1926, the exclusion under Section 911 was an unlimited exemption of foreign employment income for citizens who spent six months a year outside the United States. The exclusion was intended to benefit export salesmen and was called the "foreign trader" exemption. Over the years it has undergone a number of amendments, to exclude government employees, to introduce the concept of foreign residence and later the concept of physical presence abroad, and to introduce dollar limits to curb abuses by individuals, notably movie stars, who could arrange their employment to take advantage of the opportunity to escape U. S. tax. The principal changes are summarized in the following paragraphs.

As introduced by the House of Representatives in 1926, the "foreign trader exemption" would have excluded from taxable income the salaries and sales commissions received by U. S. citizens employed abroad for foreign sales of tangible personal property produced in the United States, provided that the recipient was employed abroad for more than six months of the year. The Senate Finance Committee rejected the House bill, arguing that the foreign tax credit made such a benefit unnecessary; but the Senate as a whole agreed with the House and even broadened the measure. As enacted into law, the forerunner of Section 911 allowed a U. S. citizen who lived outside the United States for more than six months of the tax year to exclude from his taxable income all foreign earned income. The original intention of tying the exclusion to income generated by U. S. exports never made its way into law.

In 1932, the exclusion was denied to U. S. Government employees, who are generally exempt from foreign income taxes.

In 1942, the eligibility requirement was tightened from six months absence from the United States to bona fide residence in a foreign country for an entire tax year.

In 1951, the residence requirement, which had been interpreted strictly by the Internal Revenue Service and the courts, was relaxed somewhat by providing that persons physically present in a foreign country or countries for a period of 17 out of 18 consecutive months (the "physical presence" test) could also qualify for exemption.

In 1953, the House proposed repealing the "physical presence" exemption due to abuses. The solution enacted into law was to limit the exclusion to $20,000.

In 1962, the unlimited exclusion of foreign earned income of bona fide foreign residents was limited to $20,000 a year for the first three years and $35,000 a year thereafter.

In 1964, the $35,000 maximum exclusion for bona fide foreign residents was lowered to a level of $25,000. The exclusion remained at $20,000 for the first three years of bona fide foreign residence and for those physically present abroad.

In 1976, the excludable amount of foreign earned income was reduced to $15,000, with the exception of employees of tax-exempt organizations, for whom the exclusion is $20,000. In addition, the applicable U.S. tax rate on income in excess of the excluded amount is to be calculated at the higher graduated rates, as if there were no exclusion, and the foreign income taxes which otherwise qualified for the foreign tax credit are to be apportioned between foreign taxes attributable to excluded income (no longer eligible for a U.S. foreign tax credit) and other foreign income taxes. Because these changes can in some cases result in the exclusion being less advantageous than if the taxpayer included that income and claimed the foreign tax credit, the Tax Reform Act of 1976 permits taxpayers to elect not to claim the provisions of Section 911. The 1976 Act also provides that foreign earned income which is received outside of the country in which it is earned is not eligible for exclusion if one of the purposes of receiving such income outside that country is to avoid local income tax.

III. ANALYSIS

Throughout the history of the foreign earned income exclusion there has been a thread of criticism that the foreign tax credit makes such an exclusion unnecessary. It is argued that U.S. citizens should pay the same tax without regard to where they are employed, while relying on the foreign tax credit to avoid double taxation. This line of reasoning has been opposed by the view that full taxation of U.S. citizens employed abroad would hurt the competitive position of U.S. companies in world markets, since the United States is one of only a very few countries which tax nonresident citizens on their foreign source income.

Issues considered in this review of Section 911 are: (1) the impact its repeal would have on employees and employers; (2) modifications of Section 911 contained in the Tax Reform Act of 1976; and (3) special circumstances which might warrant retention of the exclusion in its present form or otherwise.

1. Impact of repeal of Section 911 on employees and employers.

(a) Employees who would be most affected in general. In 1974, there were roughly 120,000 U.S. taxpayers who filed Form 2555, an information return reporting foreign earned income excluded under Section 911. 1/ In 1972, 100,000 taxpayers excluded an aggregate of $1.4 billion of income. The net revenue gain if the excluded income were made taxable in full is estimated at $60 million for 1976, after foreign tax credits. The changes introduced by the Tax Reform Act of 1976 are estimated to increase revenue by approximately $45 million, before taking into account the easing of the law in permitting persons using the standard deduction to claim a foreign tax credit.

The benefit of Section 911 varies inversely with the foreign tax liability, since the U.S. income tax is reduced dollar for dollar by the foreign tax paid. Thus, in general, repeal of Section 911 would hurt those who pay a foreign income tax lower than the U.S. tax and would hurt most those whose foreign earned income is exempt from foreign tax. It should be noted that in some cases it is the employer rather than the employee who would be affected; this point is brought out more clearly in Section (c).

1/ Part V summarizes some further statistical characteristics of the taxpayers claiming the benefits of Section 911.

Employment in countries where no income tax is imposed, such as Saudi Arabia and the Bahamas, would be less attractive if Section 911 were repealed. But there are also other less obvious cases in which countries which ordinarily impose high taxes grant selective tax exemption or reductions. This can occur for a variety of reasons. For example, a foreign country may treat all persons employed at a U. S. Government installation or on a government-financed project as if they were government employees and exempt their earnings from tax, even though some are employed by private firms. Some foreign countries grant special relief to employees who are not permanent residents, such as taxing them only on income received in that country, or permitting special deductions.

Certain occupations may enjoy tax relief. For example, the charters of international organizations typically provide for exemption from tax of employees' salaries. Some occupations involve extensive travel, enabling the employees to be out of the United States for seventeen months without remaining in any one country long enough to become taxable there (visits of less than six months by employees of foreign companies often do not give rise to local income tax liability). Performers, fishermen, and members of ship crews might fall in this category.

To the extent that Section 911 reduces U. S. tax, it provides an incentive to reduce foreign tax liability to the same level. Some persons may respond to this incentive by using methods that constitute tax evasion. One such method is the splitting of salaries, with one part reported for local tax purposes and the other deposited to the employee's bank account in the United States or another country, without the knowledge or approval of the foreign government. 1/ Another method is not to report income in kind as required. Where the salary is deducted in full by a local company, it is more difficult to conceal income than when part or all of the payment is made from the United States. A foreign subsidiary may try to disguise a reimbursement to the parent as royalties or technical

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1/ Under the Tax Reform Act of 1976 income earned abroad which is received outside of the country in which earned, in order to avoid tax in that country, is ineligible for the exclusion under Section 911.

service fees, but such payments are often subject to a high withholding tax. The employee may simply rely on weak local enforcement not to discover the discrepancy between the salary deducted by the employer and that reported by the employee, or to overlook income in kind.

(b) Some empirical evidence. A detailed survey of the 100,000 taxpayers claiming the benefits of Section 911 in 1968 showed that the largest concentrations were in Canada (11 percent of the total), Germany, the United Kingdom, and South Vietnam (6 percent each). With the exception of South Vietnam, these countries presumably continue to be among the principal places of residence. In 1968 they accounted for 23 percent of the total number of persons claiming Section 911.

Under the United Kingdom's remittance basis of taxation it was possible to remit to the United Kingdom only the minimum needed for living expenses and be taxed only on that amount. Some reduced their U.K. tax liability still further or even to zero by receiving none of their salary in the United Kingdom and borrowing to meet living expenses (remitted capital was not taxed). The United Kingdom tightened its remittance basis of taxation beginning in April 1975. Persons not ordinarily resident in the United Kingdom are now subject to tax on one half of their income from services performed in the United Kingdom whether or not the income is actually remitted. However, the U.K. tax on one-half the income remains below the U.S. tax on the entire income for most U.S. citizens employed there. The Canadian and German taxes are as high or higher than the U.S. tax, except for special cases, such as those private sector employees associated with U.S. bases in Germany who are exempted by German tax authorities as if they were U.S. Government employees.

Among the other principal places of residence in 1968, and presumably also today, were Japan, Mexico, Brazil, Australia, the Philippines, and Italy, all of which are high-tax countries relative to the United States, and Thailand, Venezuela, the Marshall Islands, France, Saudi Arabia, Switzerland, the Bahamas, and Bermuda, all of which are low-tax countries relative to the United States.1/ Employees in the low-tax group would experience an increased U.S. tax liability if Section 911 were repealed. But the high-tax group would be largely unaffected, since the foreign tax credit would offset most or all U.S. tax liability.

1/ See Table 10 for other examples of high and low tax countries.

From the 1968 data, tentative inferences can be drawn about some of the employees who would be most adversely affected by repeal of Section 911. U.S. citizens employed by international organizations would be affected, wherever located. Affected groups in some countries can be identified with particular industries, such as finance (Switzerland, the Bahamas, Bermuda), oil (Saudi Arabia, Venezuela) and defense contracts (the Marshall Islands and Thailand). Oil company employees in other Middle Eastern countries, Iran, Indonesia and the North Sea could also be affected since low taxes often apply in those countries by contract, for employees engaged in petroleum exploration and development.

(c) Who would bear the added tax burden, employee or employer? The next question is who would pay the increased tax? If Section 911 were repealed, the resulting increased U.S. tax liability would mean an increased total tax burden for employees subject to low foreign taxes. Whether the burden would fall on them or be passed on to their employers would depend in the first instance on the method of tax reimbursement, and ultimately on the demand for and supply of the skills of the affected employees.

The two principal methods by which U.S. firms reimburse their employees for foreign tax liabilities may be designated "tax equalization" and "tax protection", although different companies use different names. The "tax equalization" approach in effect removes the employee from the scope of Section 911. The employer calculates the base salary to approximate the amount the employee would have received after U.S. income tax if employed in the United States, and then pays the foreign tax liability incurred by the employee on that amount. Under such plans the employee does not benefit if the foreign tax is lower than the amount of U.S. tax by which the salary was reduced; the savings accrue to the employer.1/ Under "tax protection" plans the employee is paid the

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1/ For example, if the U.S. salary would be $50,000 and the estimated U.S. tax on that amount in the absence of the Section 911 exclusion is $15,000, the overseas employee would be paid $35,000. Assuming that the foreign tax on $35,000 is $10,000, the company pays that amount and keeps the other $5,000 of the $15,000 reduction in base salary. The employee adds the foreign tax payment to his income in the year it is paid, so each year there is an increased tax base even at the same salary level (as in any such tax reimbursement scheme) but the starting level is lower with this approach than under the tax protection method.

full U. S. base salary is considered subject to an assumed U. S. tax and the employer pays any excess of foreign tax over that U. S. liability. If the foreign tax is lower, the employee saves the difference. Thus, under the first approach, the immediate impact of the loss of the exclusion would be on the employer, while under the second approach the immediate impact would be on the employee.

Even where the U. S. company would compensate the employee for the full increase in U. S. tax resulting from the repeal of Section 911, some employees might have to accept a reduction in income. If there is high unemployment in that occupational field in the United States, employers may be able to offer lower premiums and allowances for foreign positions. There has been a tendency in recent years for U. S. multinationals to cut back on the various supplements paid to U. S. overseas employees. There is also a tendency to employ more foreign nationals, even where foreign laws do not so dictate, as it becomes increasingly possible to obtain comparable skills at lower costs. An increased tax liability for American employees would probably accelerate both tendencies in low-tax countries.

Americans employed abroad by foreign employers presumably would be less able to pass on to the employer an increased U. S. tax cost than those employed by U. S. companies or their subsidiaries. This would not always be the case, but the preference for U. S. labor would tend to be greatest among companies with the strongest ties to U. S. technology, methods of doing business, and working in the English language.

In general, an increased tax burden due to repeal of Section 911 would probably result in an increased cost to employers, although not necessarily by the full amount of the tax increase, lower net pay to U. S. citizens employed on foreign assignments, and an overall reduction in the employment of U. S. citizens abroad.

2. Possible exceptions or modifications if Section 911 were repealed.

(a) Employees of United States charities. The Tax Reform Act of 1976 preserved a \$20,000 per year exclusion of foreign earned income for persons who meet either the bona fide foreign residence test or physical presence (510 day) test and are employed by a U. S. organization which qualifies under Section 501 (c)(3) of the Internal Revenue Code. Such organizations may be operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. They must be created under the laws of the United States; thus foreign charities, such as the International Red Cross, do not qualify. Contributions to the qualifying organizations are deductible to the donor. The justification for preserving an exclusion for employees of such organizations is that an increase in their tax burden would be an increased cost to the non-profit organizations and would force them to cut back on their activities. The effect of the exclusion is to give such organizations an incentive to assign employees to foreign countries where the tax is lower than the U.S. tax, rather than to assign them to activities in the United States or in other countries where the tax is comparable to the U.S. tax. Employees of those organizations in the United States do not enjoy a similar exclusion.

(b) Extraordinary living expenses. One of the principal complaints of beneficiaries of the Section 911 exclusion when faced with its proposed repeal has been that they could not afford to stay at overseas assignments (or, if employers, to station U.S. citizens in overseas positions). Extraordinary living costs in many foreign posts, it is argued, would raise the required income level above the comparable U.S. level, and payment of U.S. tax on that additional salary would mean either a reduction in after tax income for the employee or a reduction in profit of the employer.

The principal component of extraordinary living costs in foreign posts seems to be housing. To rent a Western style, air-conditioned apartment in Tokyo may cost more than $1,000 a month, and costs are also very high in remote outposts where housing approximating U.S. standards is scarce.

Within the United States, costs also vary substantially, but the tax law does not adjust for such differences. To make such an adjustment for some taxpayers and not others gives a selective subsidy to employment in those high cost areas which qualify for the adjustment. Moreover, costs of living in many foreign posts are lower than the United States standard.

The point is frequently made that high living costs incurred in foreign countries do not represent any personal benefit to the taxpayer. He may in fact have preferred an apartment in Washington, D.C. for $300 a month to the one for which he must pay $1,000 a month in Tokyo. But under present law taxable income is not defined to be net of living expenses. The Tax Court addressed this issue in two recent cases concerning taxpayers who had not been reporting the portion of their rental costs paid for them by their employers. In one case the Tax Court expressed sympathy with the taxpayer's dismay at the high cost of reasonable housing in Tokyo, but observed that if the company had not paid the additional rent, the employee would have had to pay it to live in such quarters, and that therefore the company's payments did represent a financial benefit to the taxpayer. 1/ In a second similar case the Tax Court also held that the rent paid by the employer was includable in gross income of the employee because the housing furnished did not qualify as for the convenience of the employer. 2/ It can be argued that the tax law should be changed to exempt from tax a basic minimum amount to cover living costs, which would vary with the cost of living in different places and years. But the problem, as mentioned before, is a general one affecting domestic as well as foreign employees and involving lower as well as higher costs in different situations. There are also severe administrative difficulties in implementing such a concept, and its implementation would diminish the incentives for employers to locate in low cost-of-living areas.

(c) Burden of foreign sales taxes. Sales taxes imposed in foreign countries are not deductible for U.S. income tax purposes, unlike U.S. state and local sales taxes. Nor may a deduction be taken for foreign personal property taxes or contributions to foreign charities. On the other hand, foreign income taxes imposed by political subdivisions may be credited against the U.S. income tax while U.S. state and local income taxes may only be deducted. Countries with substantial sales taxes are not necessarily those with substantial local income taxes, so the two features cannot be assumed to offset each other. Foreign sales taxes are generally a more onerous burden than foreign personal property taxes. The nondeductibility of contributions to foreign charities is mitigated by the possibility of routing some such contributions through U.S. charities.

As long as state and local sales taxes are considered a proper deduction in arriving at taxable income for Federal tax purposes, a deduction for foreign sales taxes can be justified. There would be severe administrative difficulties in monitoring a deduction for actual foreign sales taxes incurred, although one could imagine a workable arrangement based on sales tax tables, perhaps initially just for high, low, and medium sales tax countries, grouped accordingly. Such an approach would move toward making the tax base computation consistent for resident and nonresident taxpayers. Alternatively, denial of a deduction for U.S. state and local sales taxes could have the same effect.

1/ T.C. memorandum 1976-13, filed January 20, 1976; Philip H. and Cherie M. Stephens vs. Commissioner of Internal Revenue.

2/ 66 T.C. ___, No. 25, May 5, 1976; James H. McDonald and Amelia H. McDonald vs. Commissioner of Internal Revenue.

3. Additional considerations.

(a) Effect on United States exports. The argument is often made that repeal of the exclusion would make U.S exports less competitive in world markets since other countries do not tax their nonresident citizens. Since the exclusion is not limited to employees engaged in export-related activities, this argument holds true only in selected cases. One such case would be where a U.S. exporter maintains a sales outlet in another country. Another would be where a U.S. firm sends employees abroad for prolonged periods to supervise the assembly, installation or use of exported products. Other activities of U.S. firms abroad, such as manufacturing, may also generate demand for U.S. exports, but the exclusion is not limited to such cases. The exclusion could, perhaps, be modified to benefit only exporters. But given the foreign tax credit, an export incentive in the form of an exclusion from gross income would necessarily be selective in its effects, favoring exports which involve the assignment of U.S. personnel to low tax countries.

(b) Competitiveness of United States firms. U.S companies with employees overseas frequently maintain that their ability to compete with third country companies (e.g. to compete against the French in Morocco) is hindered when U.S. citizens continue to be subject to U.S. tax while citizens of other countries working in such third countries pay only the host country. This situation occurs when the U.S. and foreign companies are competing in a place where the income tax is below the U.S. level, so that a net U.S. tax is due after the foreign tax credit. It does not occur if the host country income tax is as high as the U.S. income tax. Thus, the exclusion gives a tax incentive to production in low tax countries.

IV. OPTIONS

1. Retention vs. repeal of the Section 911 exclusion as modified in the Tax Reform Act of 1976. The modifications introduced by the Tax Reform Act of 1976 substantially curtailed the benefits of Section 911; consequently, outright repeal of the exclusion may now have less appeal. It can be argued that the repeal of Section 911 is too extreme. It would result in an increased U.S. tax liability for U.S. taxpayers employed abroad who pay foreign income taxes below the ordinary U.S. tax. This cost will frequently be borne by U.S. companies, while companies employing foreign nationals who are subject only to local taxes will not incur a comparable cost. On the other hand, for many U.S. employees overseas, foreign taxes are as high or higher than the ordinary U.S. rates, and Section 911 is of no benefit. Nor does it benefit recipients of other types of income, such as U.S. citizens who retire to another country. The pattern of benefits does not correspond to any stated policy objective. The administrative complexity which has long characterized Section 911 was increased rather than reduced by the 1976 amendments.

2. Repeal the exclusion but introduce a deduction for extraordinary living costs. The cost of living in some foreign locations can be considerably higher than in the United States, requiring the payment of higher salaries to attract competent employees. The Ways and Means Committee studied this question and concluded that "Given these wide variations both within and without the United States, your committee believes that the tax laws in practice cannot be fairly adjusted for these costs."(House Report 94-658, November 12, 1975, p. 200).

3. Repeal the exclusion but introduce a deduction for specific costs of foreign residence. Although cost of living differentials are not adjusted for in current U.S. tax law, and such adjustments would be difficult to make and administer fairly on a broad scale, there is some sentiment for granting tax relief to nonresident citizens for specific costs which are frequently higher in other countries. The House version of the bill which became the Tax Reform Act of 1976 (H.R. 10612) provided a deduction for tuition expenses of dependents, up to a certain amount, in recognition that language barriers, physical distance and the importance of preparation for U.S. universities make private schooling necessary in many cases where U.S. public schools would be used if available. Relief for excess housing costs is another possibility for selective relief. An excess housing cost deduction would be more difficult to administer than a tuition expense deduction and raises the question whether it is

appropriate for the U.S. Government to selectively subsidize such costs. But such a deduction offers one approach for treating private and public sector foreign service employees equitably if both the Section 911 exclusion and the Section 912 tax free allowances of overseas U.S. Government employees were replaced by uniform allowances for unusually high education and housing costs.

4. Repeal the exclusion but introduce a deduction for foreign sales taxes. Such a deduction would remove a discrepancy in the tax base which (although not expressed in terms of resident vs. nonresident U.S. taxpayers) has the general effect of putting at a disadvantage those taxpayers who reside in foreign countries. However, it would raise serious administrative difficulties. In addition, there are other discrepancies in computing the tax base, such as the allowance of a credit for income taxes imposed by foreign political subdivisions compared to a deduction for U.S. state and local income taxes. It might be appropriate to consider these various issues together.

V. STATISTICAL TABLES

1. Returns reporting a foreign earned income exclusion in 1972 compared with 1968. In 1972, approximately 102,000 returns were filed reporting a foreign earned income exclusion. The aggregate amount excluded was $1.4 billion, or an average of $13,600 per return. In 1968, nearly the same number of returns reported total excluded income of $1.2 billion or $11,800 per return (Table 1). Foreign earned income not eligible for the exclusion more than doubled between 1968 and 1972, indicating an increase in salary levels. The amount of other income subject to tax remained constant. Table 2 shows further detail on the 1972 returns, classified by size of adjusted gross income.

2. Additional data from the 1968 returns. A special tabulation was taken of returns reporting a foreign earned income exclusion for 1968. The returns were classified by amount of foreign earned income, which reveals information about the total income of the taxpayers, and information on location of the taxpayers. Those data are summarized in Tables 3 through 9.

As illustrated in Table 3, there were 101,295 returns filed for tax year 1968 reporting an aggregate of $1.2 billion of excluded foreign earned income. Two-thirds of the taxpayers, reporting 80 percent of the excluded income, identified themselves as bona fide foreign residents, as opposed to persons claiming the exclusion on the basis of physical presence abroad.

Only 15 percent of the persons claiming the exclusion had foreign earned incomes higher than the excludable maximum; however 70 percent had some income subject to tax. On average, bona fide foreign residents had $9,000 of adjusted gross income after the Section 911 exclusion, and those physically present abroad had $5,000 of adjusted gross income after the Section 911 exclusion (Table 4).

Only 17 percent of the bona fide foreign residents and 3 percent of those physically present abroad claimed a foreign tax credit, as shown in Table 5. For all returns the average credit per return amounted to 2.3 percent of total income (adjusted gross income plus the excluded income); for returns with foreign earned income of more than $25,000, the credit averaged 6.5 percent of total income.

Table 6 indicates that slightly more than half of the returns were filed by persons in developing countries. The proportion of returns claiming physical presence abroad was somewhat higher in developing countries (40 percent of the total) than in developed countries (30 percent of the total). But the size of foreign earned income varied little; in both developing and developed countries 70 percent of the bona fide foreign residents and 90 percent of those physically present earned less than $20,000.

The principal country of residence of bona fide foreign residents was Canada (Table 7). Mexico was also important, as were the United Kingdom and Germany. The other major countries of residence included Venezuela, Brazil, Switzerland and Japan. The largest groups of persons physically present abroad reflected the location of military activities, for example, South Vietnam, Kwajalein and the Marshall Islands, and Thailand. Germany, Japan and Italy also had fairly large concentrations of military activities, and substantial numbers of civilians claiming physical presence abroad as the basis for the exclusion.

Taking all the bona fide foreign residents together, 44 percent had resided abroad less than three years, 33 percent between three and ten years and 23 percent more than ten years (Table 8). Those residing in developing countries tended to have been abroad longer; however, they need not have resided in the same country the entire time.

There were 186 persons who excluded more than $25,000 of foreign earned income in 1968 (Table 9). Most of those persons had been foreign residents longer than seven years, that is, before the 1962 Revenue Act. In their case, the unlimited exclusion of foreign earned income available to bona fide foreign residents prior to 1963 continues to apply provided that the right to receive such payments existed as of March 12, 1962. The most likely form of payment to have continued into 1968 is pensions (employer contributions made prior to 1963 or related to services performed prior to 1963). Other possibilities are deferred compensation and stock options; if stock acquired by exercising an option is sold and does not qualify for capital gains treatment, the income is treated as compensation excludable under Section 911 and attributable to the year the services were rendered which gave rise to the option. For those who excluded more than $25,000 in 1968 but reported the duration of their foreign residence as less than four years (i.e., since the Revenue Act of 1964 which instituted the present limits), the most likely explanation is that they might have formerly resided abroad, either in a different country or under the physical presence rules, and reported only the dates of their present residence. Some may have used one Form 2555 to report the excludable earnings of both husband and wife.

3. Examples of high and low tax countries. Table 10 compares other countries' income taxes on the total income of U.S. employees stationed there with the U.S. income tax liability.

Table 1

Summary Data on Returns Reporting a
Foreign Earned Income Exclusion,
Tax Years 1968 and 1972

	1968	1972
<u>Number of returns</u>		
Total	101,295	101,832
With no adjusted gross income	29,622	25,799
With adjusted gross income	71,643	76,033
With taxable income	25,989	40,780
Claiming a foreign tax credit	12,449	23,914
<u>Amount of income ($ thousands)</u>		
Excluded income	1,195.8	1,381.7
Adjusted gross income (less deficit) 1/	552.7	810.0
foreign earned income not excluded	223.9	486.2
other (less deficit)	328.8	328.8
Foreign tax credit	40.8	77.3

Office of the Secretary of the Treasury
Office of Tax Analysis

1/ Adjusted gross income is defined net of the Section 911 exclusion.

Source: Internal Revenue Service, Statistics of Income 1972, Individual Income Tax Returns, Table 1.16, and unpublished tabulations of 1968 returns.

Table 2

Summary Characteristics of Returns Claiming a Foreign Earned Income Exclusion for 1972
By Amount of Adjusted Gross Income
(Amounts in $ Thousands)

Amount of adjusted gross income (AGI) 1/	Number of returns	Excluded income	Foreign earned income not excluded	Total AGI	Income subject to tax: Number of returns	Income subject to tax: Amount	Income tax before credits	Foreign tax credit: Number of returns	Foreign tax credit: Amount	Income tax after credits: Number of returns	Income tax after credits: Amount
Total	101,832	$ 1,381.7	$ 486.2	$ 810.0	40,780	$ 550.6	$ 159.3	23,914	$ 77.3	36,073	$ 82.0
Returns with no A.G.I.	25,799	214.9	0.5	-3.2	--	--	--	--	--	--	--
Returns with A.G.I.	76,133	1,166.8	485.7	813.2	40,780	550.6	159.3	23,914	77.3	36,073	82.0
A.G.I. under $5,000	42,044	567.4	34.0	70.6	*	*	*	*	*	*	*
5,000 - 10,000	12,471	222.0	61.4	83.2	11,715	38.2	6.0			9,727	2.2
10,000 - 15,000*	4,014	76.0	22.4	48.9	*	*	*	10,725	10.1	*	*
15,000 - 20,000	4,978	76.8	45.5	86.4	4,978	53.5	10.6			4,905	6.4
20,000 - 25,000	3,772	58.5	46.7	82.9	3,772	60.7	13.1	2,612	6.4	3,010	6.7
25,000 - 50,000	6,561	117.7	172.8	226.7	6,561	184.1	48.7	4,536	25.9	5,680	22.8
over 50,000	2,293	48.4	102.9	214.5	2,292	174.9	74.4	2,066	34.1	2,118	40.2

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* This bracket was based on too small a sample of returns to be relied upon separately.
1/ AGI is defined net of the Section 911 exclusion.

Source: Internal Revenue Service, Statistics of Income 1972, Individual Income Tax Returns, Table 1.16.

TABLE 3

Returns Filed, 1968, Claiming an Exclusion of Foreign Earned Income Under Section 911

Foreign Earned Income	All Returns		Bona fide Foreign residents		17 month presence test	
	Number of returns	Excluded income ($thousands)	Number of returns	Excluded income ($thousands)	Number of returns	Excluded income ($thousands)
under $5,000	22,042	$57,890	15,760	$42,692	6,282	$15,197
5,000- 10,000	22,667	162,553	14,264	100,462	8,403	62,090
10,000 -15,000	19,452	232,197	9,961	119,427	9,491	112,770
15,000 -20,000	14,515	243,341	8,270	140,082	6,245	103,259
20,000 -25,000	9,592	195,981	7,048	146,905	2,544	49,076
25,000 -50,000	11,490	263,765	10,222	238,385	1,268	25,379
50,000 and over	1,537	40,122	1,494	39,280	43	842
Total	101,295	$1,195,848	67,019	$827,233	34,276	$368,614

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Source: IRS tabulation of Forms 2555 filed in 1968.

Table 4

Returns Filed with an Exclusion of Foreign Earned Income, by Size of Adjusted Gross Income (AGI), 1968

Foreign Earned Income	Total	With no AGI	With AGI	AGI under $5,000	AGI over $25,000
All returns, total	101,295	29,652	71,643	42,833	4,311
under $10,000	44,709	16,935	27,774	18,709	461
10,000-20,000	33,967	11,435	22,532	16,361	475
20,000-25,000	9,592	1,032	8,560	5,854	307
25,000 and over	13,027	250	12,777	1,909	3,068
Bona fide residents	67,019	21,041	45,978	26,309	3,918
under $10,000	30,024	13,364	16,660	11,953	425
10,000-20,000	18,231	6,592	11,639	8,352	401
20,000-25,000	7,048	2,661	4,387	4,171	273
25,000 and over	11,716	1,085	10,631	1,833	2,819
Physical presence	34,276	8,611	25,665	16,524	393
under $10,000	14,685	3,571	11,114	6,756	36
10,000-20,000	15,736	4,843	10,893	8,009	94
20,000-25,000	2,544	172	2,372	1,683	34
25,000 and over	1,311	25	1,286	76	249

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Source: See Table 3.

TABLE 5

Returns Claiming a Foreign Tax Credit, 1968

Foreign Earned Income	Total Number of returns	Returns claiming foreign tax credit	Total Income (AGI plus the Section 911 exclusion)	Foreign Tax credit
			($ thousands)	
Total, all returns	101,295	12,449	$1,748,525	$40,795
under $10,000	44,709	1,428	350,970	1,073
10,000 - 20,000	33,967	1,529	579,768	1,598
20,000 - 25,000	9,592	1,060	247,336	1,228
25,000 and over	13,027	8,432	570,451	36,896
Bona fide residents, total	67,019	11,431	$1,248,296	$39,662
under $10,000	30,024	1,176	217,738	946
10,000 - 20,000	18,231	1,150	321,166	1,443
20,000 - 25,000	7,048	961	186,247	1,166
25,000 and over	11,716	8,144	524,145	36,107
Physical presence, total	34,276	1,018	$500,230	$1,133
under $10,000	14,685	252	133,232	127
10,000 - 20,000	15,736	379	258,602	145
20,000 - 25,000	2,544	99	61,090	62
25,000 and over	1,311	288	46,306	789

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Source: See Table 3.

TABLE 6

Returns Filed With An Exclusion of Foreign Earned Income, Developed and Developing Countries, 1968

Foreign Earned Income	All Returns	Bona fide foreign residence	17 month presence test
	(number of returns and percent of total)		
Total	101,295	67,019	34,276
under $10,000	44.1%	44.8%	42.8%
10,000 - 20,000	33.5	27.2	45.9
20,000 - 25,000	9.5	10.5	7.4
over - 25,000	12.9	17.5	3.8
	100.0%	100.0%	100.0%
Developed countries, total	40,067	31,322	12,378
under $10,000	43.8%	43.3%	49.3%
10,000 - 20,000	33.0	29.1	39.5
20,000 - 25,000	8.7	9.1	6.7
over - 25,000	14.5	18.5	4.4
	100.0%	100.0%	100.0%
Developing countries, total	53,885	35.697	21,898
under $10,000,	43.2%	46.2%	39.2%
10,000 - 20,000	34.8	25.5	49.5
20,000 - 25,000	10.4	11.7	7.8
over - 25,000	11.6	16.6	3.5
	100.0%	100.0%	100.0%

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Source: See Table 3.

TABLE 7

Principal Countries of Foreign Residence of Persons Claiming Foreign Earned Income Exclusion, 1968

	Number of returns		
	Total	Bona fide foreign residence	Physical presence
Canada	11,277	10,141	1,136
South Vietnam	6,068	1,158	4,910
United Kingdom	5,870	3,995	1,875
Germany	5,791	3,164	2,627
Japan	3,739	2,031	1,708
Mexico	3,674	3,470	204
Thailand	3,068	1,095	1,973
Venezuela	2,804	2,625	179
Brazil	2,661	2,066	595
Marshall Is., Kwajalein	2,588	326	2,262
France	2,430	1,976	454
Saudi Arabia	2,350	1,782	568
Switzerland	2,307	2,051	256
Australia	2,284	1,579	705
Bahamas, Bermuda	2,194	1,649	545
Philippines	2,183	1,419	764
Italy	2,128	1,093	1,035
Subtotal	63,416	40,041	21,091
World Total	101,295	67,019	34,276
Subtotal as % world total	62.6%	59.7%	61.5%

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Source: See Table 3.

TABLE 8

Duration of Foreign Residence of Bona Fide Foreign Residents, 1968

	Total	less than 3 years	3 - 5 years	5 - 7 years	7 - 10 years	More than 10 years
Number of returns, total	67,019	29,156	10,601	6,274	5,457	15,524
developed countries	31,322	14,639	5,291	3,265	2,555	5,576
developing countries	35,697	14,517	5,310	3,009	2,902	9,948
Percent of total	100.0%	43.5	15.8	9.4	8.1	23.2
developed countries	100.0%	46.7	16.9	10.4	8.2	17.8
developing countries	100.0%	40.7	14.9	8.4	8.1	27.9

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Note: There are minor errors in the tabulation which cause the totals to differ somewhat from the sums of their components. In computing the percentages, the totals used were 67,012; 31,326; and 35,686.

Source: See Table 3.

TABLE 9

Returns Excluding More than $25,000 of Foreign Earned Income, 1968

Foreign earned income	Total	Developed countries	Developing countries	Unidentified	Amount excluded ($thousands)	Duration of foreign residence: less than 3 yrs.	3-5 yrs	5-7 yrs	7yrs or more	uniden-tified
Total	186	92	87	7	$6,689	13	25	18	121	9
$25,000 - 35,000	127	57	65	5	3,740	8	19	14	79	7
35,000 - 50,000	51	30	19	2	2,213	5	5	4	35	2
50,000 - 100,000	2	1	1	0	112	0	0	0	2	0
over 100,000	6	4	2	0	3,624	0	1	0	5	0

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Source: See Table 3

Table 10

Examples of High and Low Tax Countries, Relative to the United States

Higher than U.S. tax	Generally higher than U.S. tax	Lower than U.S. tax
Austria	Argentina 1/	Bahamas 10/
Barbados	Australia 2/	Belgium 11/
Canada	Brazil 2/	Bermuda 10/
Chile	Costa Rica 2/	Dominican Republic
Colombia	Germany 3/	El Salvador
Cyprus	Greece 2/	France
Denmark	Iran 4/	Guatemala
Ecuador	Italy 5/	Honduras
Ethiopia	Japan 3/	Hong Kong
Finland	Malawi 6/	Kuwait 10/
India	Mexico 7/	Lebanon
Indonesia	Morocco 8/	Mozambique
Ireland	Nigeria 2/	Netherlands
Jamaica	South Africa 9/	Nicaragua
Kenya		Panama 10/
Korea		Paraguay 10/
Luxemborug		Saudi Arabia 10/
Malaysia		United Kingdom
Netherlands Antilles		Uruguay
New Zealand		Venezuela
Norway		
Pakistan		
Peru		
Philippines		
Portugal		
Puerto Rico		
Singapore		

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March 17, 1976

Source: Price Waterhouse Information Guide, Individual Income Taxes in 80 Countries, January 1975.

1/ Lower than U.S. for incomes under $25,000.
2/ Lower than U.S. for incomes under $10,000.
3/ Lower than U.S. for incomes under $20,000.
4/ Higher than U.S. for incomes of $25,000-$40,000, but lower than U.S. for other income levels.
5/ Lower than U.S. for incomes above $60,000.
6/ Lower than U.S. for incomes above $70,000.
7/ Lower than U.S. for incomes up to $10,000 and over $40,000.
8/ Lower than U.S. for incomes over $50,000.
9/ Lower than U.S. for incomes of $15,000 or less.
10/ No income tax applicable.
11/ Higher than U.S. for incomes over $80,000.

U. S. TAXATION OF ALLOWANCES PAID TO U. S. GOVERNMENT EMPLOYEES

Marcia Field

and

Brian Gregg

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I. ISSUE

Under Section 912 of the Internal Revenue Code, U. S. citizens employed outside the continental United States (and in some cases in Alaska and Hawaii) by the U. S. Government in a civilian capacity may exclude from their gross income certain allowances which supplement their base salary. The allowances in question are designed primarily to cover certain living expenses. In a number of cases, such as moving expenses, the expenses would generally be deductible as employee business expenses under current law. But other allowances, notably those for housing, cost-of-living differentials, education expenses and home leave travel, would be taxable income in the absence of the special exclusion under Section 912.

The issue to be analyzed in this paper is whether these allowances should be made taxable. 1/ A related consideration is the extent to which the tax treatment of these allowances should parallel the treatment of income earned abroad by private sector employees.

In 1974 the Ways and Means Committee voted to phase out both Section 912 and Section 911, which excludes certain foreign earned income of private sector employees. Both sections, with limited exceptions, were to be phased out over four years. That bill (H. R. 17488) was not acted on by the House before Congress adjourned. Many of its provisions concerning foreign source income were incorporated by the House in 1975 in H. R. 10612, including the phase out of Section 911. However, the Ways and Means Committee deferred consideration of Section 912 pending receipt of the report of an interagency committee which was reviewing the entire structure of overseas government allowances. Completion of that report in final form was expected to require another year, but in view of the Ways and Means Committee's interest, the interagency group completed the portion of the report dealing with tax questions and transmitted it to the Ways and Means Committee Task Force on Foreign Income as an interim report. 2/ While the Task Force report has not yet been issued, it is expected to recommend changes in this area.

1/ This paper deals only with allowances paid to civilian government employees. Military allowances are treated under different provisions of the law.

2/ Interim Report of the Interagency Committee on Overseas Allowances and Benefits for U. S. Employees, (Chairman, John M. Thomas, Assistant Secretary of State for Administration), January 1976.

II. PRESENT LAW

1. Explanation. Section 912 of the Internal Revenue Code provides an exclusion from gross income for certain allowances paid to civilian government employees. The section refers to three categories of allowances, citing in each case the statutes which authorize their payment .

(a) Foreign areas allowances. (Subsection (1) of Section 912) The first category enumerated in Section 912 refers to the various allowances paid to government employees in foreign areas. There are about 50 such allowances, which fall into eight major groups: living quarters, cost-of-living differentials (by comparison with Washington, D. C.), education of dependents, travel, expenses associated with transfers, expenses associated with separation from the foreign service, representation expenses, and residences (limited to certain officials). Table 1 gives an abbreviated description of some of the types of costs the allowances are intended to cover.

(b) Cost-of-living allowances. (Subsection (2) of Section 912) The second category excluded from taxable income by Section 912 is cost-of-living allowances, if paid in accordance with regulations approved by the President to employees stationed in the U. S. territories and possessions or in Alaska or Hawaii. The statute refers to employees stationed outside the continental United States, which for this purpose includes only the 48 states which were part of the United States in 1944, when the Revenue Act of 1943 was enacted, and the District of Columbia. To qualify for the exclusion, cost-of-living allowances paid to employees in the territories, possessions, Alaska and Hawaii must meet the second condition of being paid in accordance with regulations approved by the President. Those regulations authorize the payment of allowances to employees whose basic compensation is fixed by statute (Executive Order 10,000, 3 CFR 1943-48 comp., 792). If the basic compensation is paid from nonappropriated funds or is established by administrative order, the employee may not exclude under Section 912 any cost-of-living allowance he may receive.

(c) Peace Corps allowances. (Subsection (3) of Section 912). The third category mentioned in Section 912 covers certain allowances paid to Peace Corps volunteers and their families. This paragraph, added in 1961, is essentially limited to travel expense allowances and living allowances which do not constitute basic compensation. Termination payments and leave allowances for such individuals are specifically excluded from Section 912.

(d) Post differentials. Section 912 specifically does not apply to another category of allowance, namely differentials or "hardship" allowances. Post differentials are a percentage of base salary, up to 25

Table 1

PRINCIPAL CATEGORIES OF ALLOWANCES
OF U.S. GOVERNMENT EMPLOYEES IN FOREIGN COUNTRIES

Housing - Quarters provided or payments to cover rent and utilities.

Extraordinary Living Costs - "Post Allowance" for higher cost of living and "Separate Maintenance Allowance" where dependents must be living away from post of duty.

Education - Government provided schools or payments to cover tuition. Educational travel where appropriate schooling is not available at post of duty.

Community Services - Commissary privileges, medical care or reimbursement for medical expenses, after death services, personal transportation.

Hardship Incentives - "Post Differential" (presently taxable), Rest and Recuperative Travel, Unhealthful Post Credit

Relocation - Moving expenses (including auto), temporary lodging expenses, foreign transfer allowance for miscellaneous expenses, per diem while moving, home leave expenses, family visitation travel, emergency visitation travel, evacuation payments.

Source: Interim Report of the Interagency Committee on Overseas Allowances and Benefits for U.S. Employees, January 1976.

percent, paid to employees in locations where living conditions are uncomfortable. The Internal Revenue Service ruled in 1953 and 1959 that such payments were not excludable (Rev. Rul. 53-237, C. B. 1953-2, 52, amplified by Rev. Rul 59-407, C. B. 1959-2, 19). That position was incorporated into the statute in 1960. 1/

2. Legislative History. The predecessor to Section 912 (Section 116(j) of the Internal Revenue Code of 1939) was enacted in the Revenue Act of 1943 as an amendment introduced by the Senate Finance Committee. The exclusion covered cost-of-living allowances of employees and officers of the Foreign Service, and cost-of-living allow allowances of other U. S. Government employees stationed outside the continental United States, if received in accordance with regulations approved by the President. The reasons for excluding the allowances were that wartime inflation was seriously reducing their value, particularly for foreign service personnel in Europe, that increases in allowances were partly nullified by the increase in tax, resulting from the Revenue Act of 1943, and that the State Department did not have the funds or authority to compensate the recipients for the added burden of the tax.

The Foreign Service Act of 1946 expanded the allowances and benefits authorized for foreign service officers and employees. The additional allowance included amounts payable for housing, cost-of-living , representation costs, and travel expenses (for moving, home leave, and sick leave). That Act also added Section 116(k) to the 1939 Internal Revenue Code to provide a tax exemption for such additional allowances.

Section 912 of the Internal Revenue Code of 1954 was identical to Section 116(j) and (k) of the 1939 Code. In 1960, the 1954 Code was amended to add an exemption for allowances authorized under certain other Acts and to confirm the IRS position that post differentials were not excludable.

In 1961, certain Peace Corps allowances were added to the list of exclusions. The Treasury Department at that time expressed concern at expanding the list of benefits excluded from income.

1/ In 1973, a new allowance was introduced to cover the additional housing and utilities costs incurred by U. S. Government employees stationed at U. N. headquarters in New York City who have entertainment responsibilities. Not more than 45 employees may claim the allowance at any one time. The amount is set to approximate the excess cost of housing and utilities in the neighborhood of the U. N. headquarters over the average of such costs in the metropolitan New York City area. The tax status of this allowance is not clear.

III. ANALYSIS

1. Scope of the exclusion. As illustrated in Table 2, there are approximately 100,000 civilian government employees who receive one or more allowances that are excluded from income under Section 912, of which about 40,000 are employed in foreign countries, 20,000 in U.S. territories and possessions and 40,000 in Alaska and Hawaii. Roughly 60 percent of the total are civilian employees of the Department of Defense.

There are some 50 different allowances. The allowances for foreign areas are administered by the State Department, while those for non-foreign areas are administered by the Civil Service Commission. However, each of the 38 participating agencies may make its own variations in determining the amounts and conditions of allowances. Table 3 identifies the principal foreign countries where civilian U.S. Government employees are located.

The aggregate amount of allowances is not reported, nor does each agency report allowances separately in its budget. For example, the Defense Department, the largest single employer of personnel covered by Section 912, records some civilian allowances with those of the military. The estimated total for all allowances increased from $244 million in 1972 to $343 million in 1975, as shown in Table 4. The estimated revenue cost in 1975 of excluding the allowances from taxable income was roughly $100 million, based on salary levels, location, and assumed family size. This is a gross figure which only relates to the revenue side of the budget; it does not take into account that the tax exempt nature of the allowances is in part reflected in lower salaries or lower allowances. If the allowances were subject to tax there would have to be some offsetting increase on the expenditure side of the budget in the amounts paid to maintain the same level of disposable income for the employees.

Some of the allowances exempted from tax by Section 912 represent a reimbursement of expenses which ordinarily would be deductible (e.g., moving expenses), or payments which are excluded from taxable income under other sections of the Code (for example, the U.S. Government contribution to employee health insurance plans). However, within this group, there are several instances where the tax regulations for claiming allowable deductions were designed with domestic employment in mind and may not adequately take into account the requirements of overseas employment. The limit under the moving expense deduction of 30 days for household storage is one such example. Thus, if Section 912 were repealed, equitable treatment of overseas employees would require that present regulations be reviewed to adequately consider foreign employment circumstances.

There are four principal allowances, accounting for a substantial portion of the total, which would become taxable income if Section 912 were repealed, those for cost-of-living differentials, housing, education,

Table 2

Number of Federal Civilian Employees Eligible for
Section 912 Benefits by Area and Agency, 1968, 1972 and 1975

	1968				1972				1975			
	Total	Dept. of Defense	Dept. of State	Other Agencies	Total	Dept. of Defense	Dept. of State	Other Agencies	Total	Dept. of Defense	Dept. of State	Other Agencies
Total	104,261	64,791	12,259	27,211	95,626	58,652	8,733	28,241	97,488	61,234	6,985	29,269
Overseas: 1/	62,413	35,587	12,259	14,567	55,082	32,145	8,733	14,204	57,488	35,234	6,985	15,269
Foreign countries	41,887	25,671	12,240	3,976	33,134	21,817	8,732	2,585	37,167	27,515	6,985	2,667
U.S. territories	20,526	9,916	19	10,591	21,948	10,328	1	11,619	20,321	7,719	-	12,602
Alaska and Hawaii 2/	41,848	29,204	-	12,644	40,544	26,507	-	14,037	40,000	26,000	-	14,000

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December 1976

1/ Calendar year averages.

2/ Figures for Alaska and Hawaii for 1968 and 1972 are as of December 31. The 1975 figures are estimates.

Source: U.S. Civil Service Commission. Federal Civilian Manpower Statistics, various (monthly) issues. For January through March 1968, Federal Employment Statistics Bulletin, Employment and Turnover.

Table 3

Principal Locations of Civilian U.S. Government Employees in Foreign Countries, FY 1975

All foreign countries 1/	38,592
Germany	13,493
Japan	5,271
Korea	1,521
The Philippines	1,399
The United Kingdom	1,357
Italy	1,094
Thailand	1,066
Spain	714
Subtotal	25,915
All others	12,677
Selected other countries:	
Mexico	321
Canada	201
Belgium	405
France	410
The Netherlands	129
Barbados	274
Bermuda	255

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March 22, 1976

1/ Excludes about 20,000 employees in the territories and possessions and 40,000 in Alaska and Hawaii who also qualify for some benefits under Section 912.

Source: U.S. Department of State, Office of Personnel Reports, U.S. Citizens Residing in Foreign Countries -FY 1975.

TABLE 4

Federal Civilian Employees Eligible for Section 912 Benefits; Estimated Salaries, Allowances Excludable under Section 912, and Associated Revenue Loss by Area, 1968, 1972, and 1975
(Dollars Millions)

	1968	1972	1975e/
Salaries			
Total	$880	$1,246	$1,555
Overseas	577	773	1,020
Foreign countries	431	510	740
U.S. territories	146	263	280
Alaska and Hawaii	303	473	535
Allowances			
Total	179	244	343
Overseas	156	209	303
Foreign countries	131	165	256
U.S. territories	25	44	47
Alaska and Hawaii	23	35	40
Revenue Loss			
Total	51	76	100
Overseas	45	66	89
Foreign countries	39	50	77
U.S. territories	6	11	12
Alaska and Hawaii	6	10	11

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Office of Tax Analysis

March 24, 1975

Source: Estimates based on data from U.S. Civil Service Commission, Pay Structure of the Federal Civil Service; U.S. Department of State, Standardized Regulations (Government Civilians, Foreign Areas); and Comptroller General of the United States, Fundamental Changes Needed to Achieve a Uniform Government-wide Overseas Benefits and Allowances System for U.S. Employees, September 1974.

e/ Estimated

and home leave travel. As already mentioned, post differentials or "hardship" allowances are specifically excluded from Section 912 and would not be affected by its repeal.

2. Justification for the exclusion. When it introduced the exclusion of living allowances of U. S. Government employees outside the United States, in 1943, the Senate Finance Committee stated,

> "Payment of allowances to meet the extra cost of living at individual posts is indistinguishable from the payment of allowances to defray expenses of operation of the establishment..."

The Committee concluded that since the State Department had neither the funds nor the authority to increase the allowances enough to offset the tax on them, tax exemption was the appropriate solution.

This line of reasoning continues to serve as the justification for the Section 912 exclusion. In brief, the justification is as follows: (a) the expenditures covered by the allowances do not represent a personal benefit to the recipient, but solely a reimbursement for costs incurred as a result of the employment assignment; (b) these expenses must, therefore, be borne by the employer; (c) the employer can either increase the payments to cover the tax on them, or exempt them from tax; (d) tax exemption is the only practical alternative for U. S. Government employees, where the ability to alter compensation levels is limited; and (e) this case is distinguishable from that of private sector employees overseas and from U. S. Government employees in the United States. The various elements of this reasoning are considered in the following sections.

(a) Personal benefit vs. reimbursed costs. The general case for exempting government allowances usually rests on the argument that the allowances are not additional compensation to the employee, but simply reimbursement for costs necessitated by the conditions of employment, and therefore do not properly constitute taxable income of the employer. In other words, the allowances are designed to leave the overseas government employee in the same net position in terms of disposable income as his counterpart in the United States.

While in general the allowances are designed to cover only extra living costs, there are some cases where the amounts paid intentionally go beyond that standard. The principal example is the housing allowance, which provides free housing, including utilities, rather than just the excess of the cost of housing and utilities at the particular post over what the employee would have paid in the United States. The State Department recognizes that this allowance confers a personal benefit:

> As a financial inducement to overseas service, Government employees stationed abroad are furnished either with free Government acquired housing or an allowance to cover the cost of privately rented quarters. This provides the employee with additional income, equal to what he would have spent on housing in the United States, that is available for spending on other goods and services. 1/

Another example of an allowance which covers more than the additional cost necessitated by overseas employment, in contrast to domestic employment, is payment of home leave travel for the whole family to any point in the United States.

Much of the recent criticism of exempting the allowances is directed at cases where allowances, although intended to offset necessary costs, do confer personal benefit, leaving the recipient better off than his domestic counterpart. Two recent studies, one by the Office of Management and Budget in 1973, and one by the General Accounting Office in 1974, called for an overhaul of the entire system of measuring and paying allowances to remedy the lack of uniformity and excessive allowances.

In some cases foreign living costs are lower than in the United States (e.g. household help may be available at a low cost). If the rationale for the tax-free allowances were merely to equalize the positions of foreign and domestic employees, there should logically also be some provision for a reduction in base pay (a negative allowance) in certain cases.

Some observers would argue that exclusion from income is appropriate only for those allowances which reimburse the overseas employee for living costs above what he would incur in the United States, and that exemption of that part of the allowance which exceeds the living cost differential provides a windfall to the recipients, leaving them better off than their counterparts in either the private or the public sector. Others would contend that, with very limited exceptions, 2/ the allowances are basically all income, whether or not they represent a reimbursement for excess costs, and that any exemption represents a windfall to the recipient.

1/ U. S. State Department, "Indexes of Living Costs Abroad", April 1975, published by Labor Department, Bureau of Labor Statistics (underscoring added).

2/ Nearly all observers would make an exception for certain allowances such as those designed to cover evacuation and funeral expenses.

The case for tax exemption is weakest in those instances where the allowance is for costs which the employee would incur in any event. In fact, the existence of windfalls within the allowances structure and the difficulty of eradicating them may be a reason for taxing all of the allowances; there may be less resistance to paying tax on the allowances than to reducing them. At the same time, the absence of tax exemption would remove the incentive to overstate the allowance portion of total compensation.

(b) Cost must be borne by employer. Other things being equal, an employee will not accept the same pay for the same work in two different places if living costs are much higher in one place than in the other. Other things are of course seldom equal. Different work, pleasant surroundings, useful experience and other elements of "psychic" income may induce an employee to accept a lower income in one post than he could earn in another. But on the whole it is fair to say that higher living costs must be reflected in higher compensation to attract the same quality of personnel.

Assuming that government employees accept overseas assignments only if their disposable income after necessary expenses can be maintained at the same level as when they were employed in the United States, and assuming that the allowances were revised so that they covered only the extra living costs incurred as a consequence of employment outside the United States, then taxation of the allowances would reduce the attractiveness of foreign employment and would presumably have to be compensated by higher government salaries or allowances. 1/

(c) Tax exemption vs. higher pay. If overseas living allowances were made taxable, the ultimate result in most cases would be an increase in cost to the employer, the U. S. Government. Whether the increase in compensation would be the same or less than the increase in tax costs would depend in part on whether the allowances cover the total costs of living abroad or only the excess over the costs of living in the United States. As the Senate Finance Committee noted in introducing the forerunner of Section 912 in 1943, tax exemption is one method of bearing the cost--a substitute for increasing the allowance directly.

Tax exemption of a particular group is a cost borne by taxpayers in general, but when the U. S. Government is the employer, paying higher salaries is also a cost to taxpayers in general. Therefore, in one sense, taxing the allowances would amount to taking money from one pocket and putting it into another. But this argument suggests that no government

1/ Unlike private sector employees overseas, U. S. Government employees are not subject to foreign tax on their earnings. An increase in U. S. tax, therefore, would be felt in full by the employee, since there is no foreign tax credit to offset the U. S. tax.

employee should be taxed on his salary. Considered in this light, the logic is questionable. If government salaries were generally made tax exempt as a cost-cutting device, the result would be highly deceptive budgeting. Government agencies would have an incentive to use more labor than necessary because its cost would appear lower than it really was. Moreover, the tax free status of government salaries would appear highly inequitable to the vast majority of Americans.

These considerations also apply to the case of overseas allowances. The exemption creates an incentive to pay higher allowances and to hire more persons than necessary. The emphasis on allowances may also be reflected in the employees being underpaid in terms of base salary. The actual cost incurred by each agency is understated since part of the personnel budget is reflected in lower tax collections by the Treasury Department. In fact, as mentioned earlier, the allowances themselves are not adequately reported, so that it is difficult to determine the gross pay of U. S. Government employees in different locations. Moreover, the exemption of government allowances may seem inequitable to persons who, for one reason or another, incur high living costs which are not recognized in computing taxable income.

The taxation of allowances can be seen as penalizing an employee with a substantial amount of income in addition to his government salary, by comparison with a similar employee having no outside income. If the allowances are viewed as marginal income, then under a progressive structure of tax rates, the net benefit of the allowance to the employee with outside income would be less than to the employee with no outside income; if the allowances are not taxable, both would benefit equally. Alternatively, however, the allowances can be viewed as the first slice of income or as the slice on top of the salary, and the outside income can be viewed as the marginal income taxed at a higher rate.

The difference between these two perceptions highlights the general question of tax recognition of differences in the cost-of-living between different locations or over time. U. S. tax law does not generally take such differentials into account. Making such adjustments would be very complex. To provide selective relief to certain groups raises the question of equitable treatment of those taxpayers not favored by the adjustments. (This point is considered further under Section (e) below.)

(d) Practical consideration: exemption vs. higher pay. If the allowances now exempt under Section 912 were to become taxable, the gross or budgeted cost to the government agencies of maintaining their foreign staffs would have to be increased in order to maintain a necessary level of disposable income for the employees. Additional appropriations would be required for the employing agencies. This would require special attention to alleviate statutory or administrative restraints on additional spending.

Under present appropriations procedure, Congress might not adequately take into account the offsetting additional tax on the increased allowances. For example, if an employee whose marginal tax rate is 33-1/3 percent has $6,000 of allowances, and the U. S. Government wants to reimburse him fully for the tax liability on those allowances, it would have to increase the allowances from $6,000 to at least $9,000, an increase of 50 percent. The net cost to the U. S. Government would be zero in this case since the added tax of $3,000 matches the added allowance of $3,000; but the tax revenue is not credited to the agency which must pay the allowance.

To the extent that certain allowances tend to overcompensate the employee (for example, housing, home leave, travel, rest and recreation), there could be a net budgetary gain if the allowance is not raised by the full increase in the tax. In the example mentioned above, the Government might increase the allowances from $6,000 to only $7,500, so that the after-tax amount would be $5,000 instead of $6,000; then the increased cost of $1,500 would be more than offset by the increased tax of $2,500. But again the net revenue gain will not be reflected in the employing agency's budget requests which must be approved by Congress.

Under present law, the personnel budgets of employing agencies are understated since they do not reflect the appropriate tax costs. A change from tax exemption of allowances to taxation as ordinary compensation would correct this situation. But such a change should be accompanied by adjustments in the budget process necessary to make this policy practical.

(e) Distinguishing overseas government employees from other employees. The principal reason for paying the allowances is to compensate for increased living costs in certain locations. Differential living costs are also encountered by private sector employees overseas and by U. S. Government employees in the United States, and are similarly reflected either in varying amounts of compensation or in difficulties in filling positions at certain locations. The argument for exempting the allowances from tax is basically an argument that in the case of government employees outside the United States part of differential living costs should be borne by taxpayers in general rather than by the particular employee. This argument has fundamental shortcomings, as noted earlier.

If tax adjustments for differential living costs are not made as a matter of general policy, the question remains whether adjustments should be made for a particular group. Part of the answer to this question depends on whether such adjustments seem inequitable by comparison with the tax treatment of similar groups.

In deciding to phase out the foreign earned income exemption of private sector employees, the Ways and Means Committee said:

> Your Committee notes that some of the same reasons for repeal of the exclusion for private industry employees might be equally valid to the exclusions for governmental employees. 1/

The comparison between overseas government employees and government employees stationed in the United States is in some respects better than the comparison with private sector employees overseas. The only relevant tax for overseas government employees is the U. S. tax, whereas overseas private sector employees are affected by the foreign tax liability and foreign tax credit. However, where a government and private sector employee work side by side in a foreign country and receive the same gross pay, it is difficult to justify exempting the living allowances of one and not the other. The Task Force on Foreign Income of the Ways and Means Committee studying the taxation of both private and public sector employees overseas felt that the two groups should be treated equitably. The Task Force Report is not yet issued. During its deliberations, the Task Force tentatively favored recommending that both the Section 911 exclusion and the exemption of government allowances be phased out with special relief for housing and education expenses and for construction workers. These deliberations occurred before enactment of the Tax Reform Act of 1976.

3. Other considerations.

(a) Official expenses. Some allowances may be viewed as representing reimbursement for official expenses. As such, they may be either excluded, or included in income and allowed as a deduction. However, those expenses which are business expenses under current law would not include many important allowances, such as the cost of living, education or housing allowances. To broaden the limits of deductibility would raise a serious problem of where to draw the line for overseas government employees as well as for government employees based in the United States and private sector employees based overseas.

(b) Education expenses. The situation of government employees is parallel to that of private sector employees with respect to expenses incurred in providing elementary and secondary schooling for dependents: publicly financed schooling might be inadequate, and the families may have to rely on private schooling. The State Department regulations

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1/ House of Representatives Report 94-658, November 12, 1975, page 200.

provide allowances to cover the cost of transportation, room and board, tuition and other school expenses at a private school where the local facilities are judged inadequate.

The House version of H. R. 10612 would have provided a deduction of $1,200 per year per child (up to 19 years old) for tuition expenses paid by private sector employees when both the taxpayer and the dependent were in one or more foreign countries for 330 days in a 12 month period. The 330 day requirement for the taxpayer may be strict for those employees, both private sector and government, who have to return to the United States on business frequently or for extended periods. The amount of the deduction was also felt to be too low in some cases. The Task Force on Foreign Income of the Ways and Means Committee tentatively concluded that a higher figure, perhaps $2,000, would be more appropriate. The problem was to balance the extra burden borne by private and government employees abroad against the considerations that: (a) they may not pay U. S. state and local taxes, which finance most U. S. public education at the elementary and secondary levels; (b) many U. S. residents who do pay state and local taxes nevertheless use private schools for their children without being allowed a deduction for the added costs; and (c) some of the schools used by foreign service employees are church-sponsored. As enacted, the Tax Reform Act of 1976 reduces the Section 911 exemption but does not phase it out entirely and does not contain the tuition expense deduction.

(c) Housing costs. Government and private sector employees face the same problems of high cost housing in many foreign cities. However, government employees have their full housing, including utilities, provided by their employer, and are not required to report any part of that as taxable income. Table 5 gives some recent examples of housing allowances in various foreign cities. Private sector employers frequently pay part of the housing and utility costs of their overseas employees, typically the excess over the estimated U. S. cost or the excess over some percentage of the salary, but the employer-paid portion is considered taxable income to the employee.

Some argue that housing provided by the U. S. Government for overseas employees serves the convenience of the employer and therefore should not be taxable to the employee. The standards for determining when employer provided housing is provided for the convenience of the employer are fairly stringent under current law. Section 119 of the Internal Revenue Code sets forth a three-pronged test. The lodging must be for the convenience of the employer, it must be on the business premises of the employer, and the employee must accept the lodging as a condition of his employment. The three tests must be met if the value of the lodging furnished by the employer is to be excluded from

Table 5

Examples of State Department Housing Allowances, as of January 1976

	Annual allowances for an employee with dependents earning basic salary of $15,000-$26,999
Frankfurt	$4,300
Tokyo, (city)	4,500
Seoul	4,400
Manila	3,800
London	5,100
Rome	7,200
Bangkok	4,400
Madrid	6,500
Mexico City	6,400
Ottawa	5,600
Brussels	8,500
Paris	9,400
the Hague	6,900
Barbados	5,500
Iran	7,400
Kuwait	7,000

Office of the Secretary of the Treasury
Office of Tax Analysis

March 26, 1976

Source: U.S. Department of State, Allowances Staff the gross income of the employee. There are numerous rulings and court cases interpreting these rules. Lodging provided to workers at remote construction sites is excludable, for example. The Ambassador's residence presumably would be excludable in accordance with Rev. Rul. 75-540, which holds that a state Governor's mansion is for the convenience of the employer. But in their present form, the statutory tests would be difficult for the average foreign service employee to meet, and if section 912 were repealed, free housing of overseas employees would in most cases be taxable income to the government employee.

Congress could legislate special relief from the added burden which would result if foreign employee housing allowances were subject to tax. One question then would be whether such relief should be made available to private sector employees in similar circumstances. In both cases, the principal beneficiary would be employers with overseas staff. The Ways and Means Committee Task Force on Foreign Income tentatively supported the idea that both the tax exemption of government allowances and the private sector foreign earned income exclusion should be phased out, with special relief for added housing costs and a tuition expense deduction for both groups.

One possibility would be to allow a deduction for the portion of housing costs incurred for business purposes, such as official entertainment. Such a rule, however, would be difficult to administer and complicated for the taxpayer who would have to pro-rate rent and utilities.

Another possibility would be to allow a deduction for the cost of foreign housing in excess of the cost incurred by employees in the United States for comparable housing. The standard of reference might be expressed in terms of a percentage of income typically spent on housing or in term of actual housing costs in a selected U. S. city. Since domestic employees do not enjoy tax relief for high housing costs, it might be desirable to limit any such relief to costs above a reasonably high U. S. base, and perhaps to provide an upper limit to minimize any incentive to acquire lavish housing by Americans overseas. In addition to determining the amount of such a deduction, there would have to be rules defining its scope. What is included in housing costs: utilities, telephone, cable TV? Who is eligible: government employees in the possessions, Alaska, Hawaii, New York? If private sector taxpayers also qualify, does this include self-employed persons, employees of foreign firms, corporate directors? Must housing be furnished to all employees? Rental values would have to be imputed in many cases.

Such a relief provision would be complex and difficult to administer. But the government allowances and the Section 911 exclusion are already complex and difficult to administer. Furthermore, there is precedent in the Code for allowing deductions for extraordinary personal expenses (for example, medical expenses in excess of 3 percent of adjusted gross income). A special deduction for "excess" housing costs would have the advantage of focusing relief on a particular expense related to the location of the employment and could be limited to the portion of that expense which exceeds the cost of comparable housing for employees in the United States.

IV. OPTIONS

1. Retain present law. This alternative would put the least strain on employing agencies and affected employees. The present system of exempting tax allowances paid to government employees outside the United States, and in some cases in Alaska and Hawaii, reduces the cost to the employing agency of maintaining U. S. citizens in those posts. It has been argued that most allowances just offset the higher living costs entailed by an overseas assignment. However, the exemption can amount to preferential tax treatment for a certain group of government employees compared to government employees in other locations and compared to private sector employees in the same locations.

2. Repeal the Section 912 exclusion entirely. This alternative would subject to tax all of the allowances now excluded under Section 912. Some of the allowances would not be taxable, due to offsetting expense deductions permitted under other sections of the Internal Revenue Code, but many allowances, including those for education, cost-of-living increases, and housing would become taxable. The employing agencies would thus need increased appropriations.

3. Allow a deduction for housing costs in excess of the costs of comparable U. S. housing, and a special tuition expense deduction.

(a) Housing. A deduction for "excess" housing costs above those which the employee would have incurred if employed in the United States would deal with the principal component of extraordinary living costs associated with foreign employment. It would significantly reduce the added tax liability of employees in areas where desirable housing is scarce, and would, therefore, relieve the budget burden on the employing agencies. At the same time, taxing the other allowances would reduce the windfall element and permit more accurate accounting of the costs of the overseas operations. On the other hand, there would be the problems of drawing the line to avoid encouraging lavish housing and of defining the standard so as to minimize discrimination against employees in the United States in high cost areas.

1/ The Tax Reform Act of 1976 reduced the Section 911 exclusion to $15,000 in most cases and provided that the exempt amount is taken into account in determining the rate applicable to non-exempt income and that foreign taxes paid on exempt income may not be credited against U. S. tax on other foreign income.

The net revenue cost of such a deduction for government employees would be small, since housing allowances in excess of the permissible deduction would be taxable, and since in the absence of the deduction the government would have to increase the allowances to attract the same quality of personnel. Assuming that similar relief were made available to private sector employees, the revenue costs of such a deduction for the latter group would be greater, since there would usually be no offsetting effect on outlays (there could be some offset where the allowance is a deductible expense for computing the U.S. tax of a U.S. employer).

(b) Tuition. As noted earlier, the House version of H.R. 10612 provided a deduction for tuition expenses of employees of up to $100 per month per child, and the Ways and Means Task Force considered recommending an increase and extending it to public sector employees, along with some relief to both groups for housing costs. This combination would ease the principal expense burdens on overseas employees. As with a housing allowance there would be difficulty in designing an equitable tuition expense allowance.

4. Other statutory relief. Specific statutory relief should be considered for several of the minor allowances which, though they might be treated as taxable income in the absence of Section 912, could be justifiably excludable from income or deductible. This category might include allowances for emergency evacuation from a post and allowances for preparation and transportation of remains of a deceased employee.

In addition, the rules for deductibility of certain expenses, such as moving costs, deserve to be reviewed from the viewpoint of employment outside the United States; special rules may be warranted in such cases.

5. Make Section 912 inapplicable to employees serving in Alaska or Hawaii. Although employees in Alaska and Hawaii constitute about 40 percent of Federal employees eligible for the Section 912 exemption, the revenue loss attributable to their allowances is relatively small. But the distinction between employees serving abroad and those serving at domestic posts (both groups encounter variable living costs) is confused by continuing to exempt cost-of-living allowances paid to employees in Alaska and Hawaii when the tax law does not recognize cost-of-living differentials for U.S.-based employees in general. If Section 912 were replaced by special relief for housing and education costs, this anomaly would disappear. Even if it is retained, deleting Alaska and Hawaii from its scope deserves consideration.

TAX TREATMENT OF INCOME OF FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

Jon Taylor

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I. INTRODUCTION

The United States unilaterally exempts foreign governments and international organizations from tax on certain income from sources within the United States. This exemption includes organizations which are separate in form from a foreign government provided the organization meets certain requirements. The exemption is extended, on a reciprocal basis, to the compensation of alien officers and employees of foreign governments and international organizations.

These exemptions reflect the generally accepted principle that one government does not tax another. While some foreign governments benefiting from these provisions of the Internal Revenue Code have reciprocal exemptions concerning U. S. Government income arising from investment in their country, many do not. Few foreign governments explicitly exempt other foreign governments from tax on income generated in their country. Countries that do provide such exemptions generally do so on a reciprocal basis only. Brazil, for example, exempts foreign governments from the provisions of its income tax law only if an equivalent exemption is granted to the Brazilian government by the foreign country. 1/ Foreign governments such as Sweden, France, Germany, and the United Kingdom do not explicitly exempt foreign governments from tax on income sourced within their respective countries. These countries do, however, provide various exemptions for diplomatic representatives, foreign consular representives, and other official agents of foreign governments. 2/ The principle of exempting international organizations and their employees from local income tax is the most universal tax exemption afforded members of the international community.

1/ W. S. Barnes, ed., World Tax Series: Taxation in Brazil (Boston: Little, Brown and Company, 1957), p. 92.

2/ For an explanation of the tax treatment of official foreign entities in these countries see: W. S. Barnes, ed., World Tax Series: Taxation in Sweden (1959); Taxation in France (1966); Taxation in the Federal Republic of Germany (1963); and Taxation in the United Kingdom (1957), (Boston: Little, Brown and Company).

Similar, though less extensive, reciprocal tax exemptions are also contained in bilateral income tax treaties between the United States and some of its treaty partners. 1/ In addition, the United States is a party to numerous international treaties which exempt from tax members of the armed forces and certain of their auxiliary organizations. United States military personnel, for example, assigned to Germany as members of NATO, are exempt from tax in Germany. 2/

The tax exempt status of foreign governments and international organizations has become a sensitive issue in light of the recent increase in foreign government investment in the United States, particularly from the OPEC countries, and the changing nature of this investment. Changes in the extent and form of foreign governmental organizations, and the creation of quasi-governmental organizations, have raised important questions concerning the scope of the existing statutory exemption. The Internal Revenue Service has issued guidelines concerning some of the issues raised by the exemption. 3/ This approach has not been entirely satisfactory, as the guidelines have neither kept pace with the numerous variations in the form of investment nor the form of the foreign governmental organizations. Thus, the Internal Revenue Service has had to consider many exemptions on a case-by-case basis--a process which creates uncertainty and delay.

This paper examines the U. S. tax treatment of income received by foreign governments and international organizations from investments in the United States in stocks, bonds, or other domestic securities, from interest on deposits in U. S. banks, and from other sources. A related issue is the tax treatment of compensation paid to employees of foreign governments and international organizations.

1/ For example, Article 10 (interest) of the income tax convention between the United States and France provides that: "Interest received by one of the Contracting States, or by an instrumentality of that State not subject to income tax by such State, shall be exempt in the State in which such interest has its source." The convention does not, however, exempt dividends received by the Governments of the Contracting States. Hence, the exemption contained in the income tax convention is not as extensive as the statutory exemption. U. S. Department of State, Treaty Series, Income Tax Treaty Between France and the United States, TIAS 6518, July 11, 1968.

2/ W. S. Barnes, ed., World Tax Series: Taxation in the Federal Republic of Germany (Boston: Little, Brown and Company, 1963), p. 245.

3/ Rev. Rul. 75-298, 1975-2 C. B. 290.

II. PRESENT LAW

1. Exemption of foreign governments from U. S. tax. Section 892 of the Internal Revenue Code provides that the income of foreign governments or international organizations received from investments in the United States in stocks, bonds, or other domestic securities, or from interest on deposits in banks in the United States, or from any other source within the United States, will generally be exempt from U. S. tax provided the investments and deposits are owned by the foreign governments. 1/ Any income collected by foreign governments from investments in the United States will not be exempt from tax if the stocks, bonds, or other domestic securities generating the income are not actually owned by, but loaned to, the foreign governments. 2/ The exemption of foreign government income from U. S. tax applies to their political subdivisions.

The exemption was originally enacted as part of the Revenue Act of October 3, 1917 3/ which amended Section 30 of the Revenue Act of September 8, 1916. The original exemption read as follows:

> That nothing in Section II of the Act approved October third, nineteen hundred and thirteen, entitled 'An Act to reduce tariff duties and to provide revenue for the Government, and for other purposes', or in this title, shall be construed as taxing the income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States or moneys belonging to foreign governments.

1/ For purposes of Sections 892 and 893 (dealing with employee compensation), the European Communities (European Coal and Steel Community, European Economic Community, and European Atomic Energy Community) collectively and individually constitute a foreign government. To date these are the only supranational organizations qualifying for a Section 892 or 893 exemption. No rationale was stated in the revenue ruling as to why these organizations qualify for the exemptions, nor was any guidance provided as to the criteria which should be used to evaluate future requests by other supranational organizations for tax exempt status under Sections 892 and 893. Rev. Rul. 68-309, 1968-1 C. B. 338.

2/ Regulations 1. 892-1 (a).

3/ U. S. Congress, House, An Act to Provide Revenue to Defray War Expenses, and For Other Purposes, Public Law 50, 65th Cong., 1st sess., 1917, H. R. 4280, Title XII (Income Tax Amendments) Section 30.

The exemption was first amended in 1918. This amendment expanded the categories of income covered by the initial statute to include income "from any other source within the United States". 1/ At this juncture the first legislative history appears concerning the statutory foreign government tax exemption. This history is confined to a mere paragraph contained in the Ways and Means Committee report stating that the bill includes "income of foreign governments from any other source within the United States". 2/ The inclusion of the language " or from any other source within the United States" arguably broadened the scope of Section 892. However, there was no substantive legislative comment on the intended scope of the provision. In 1920 the Service chose an extremely broad interpretation of the 1918 statute by ruling that "a foreign government is not subject to tax on income derived from the operation of vessels owned by such government through its agents in the United States. Neither is the foreign government liable to tax upon the income arising from the operation for its benefit of vessels chartered by it." 3/ This ruling was declared obsolete in 1968, and can no longer be used as a guide. However, the fact that the ruling was declared obsolete provides little guidance in delimitating Section 892. 4/ The scope of Section 892 remains unresolved, particularly in light of the fact that the phrase "or any other source" has yet to be satisfactorily defined.

1/ U.S. Congress, House, An Act to Provide Revenue, and For Other Purposes, Public Law 254, 65th Cong., 2nd sess., 1918, H.R. 12863, Title II, Part II, Section 123(b)(5).

2/ U.S. Congress, House, Committee on Ways and Means, Revenue Bill of 1918, Committee Report on H.R. 12863, House Report No. 767, 65th Cong., 2nd sess., 1918. See also 1939-1 Part 2, C.B. 92.

3/ Office Decision 515, 1920-2, C.B. 96. (Declared obsolete by Rev. Rul. 68-575.)

4/ The procedure of declaring rulings obsolete is a systematic effort on the part of the Service to identify rulings which are no longer to be considered determinative with respect to future transactions. "The public announcement that a particular ruling is not determinative with respect to future transactions does not necessarily mean that the conclusion or the underlying rationale has no current applicability." 1967-1. C.B. 578.

A second amendment, in 1945, included in the exemption income received by international organizations.1/ The term "international organization" was defined in the International Organizations Immunities Act of 1945 (22 U.S.C. 288) as a public international organization in which the United States participates pursuant to any treaty or under the authority of any Act of Congress authorizing such participation.2/ International organizations qualifying for the exemption under Section 892 are those organizations designated by the President through Executive Order. A list of presently exempt organizations appears as Appendix A.

The requirements for tax exempt status of foreign organizations related to, but separate in form from, a foreign government have changed several times since the enactment of Section 892. Currently, income earned by an organization created by a foreign government which does not engage in commercial activities on more than a de minimis basis in the United States qualifies for the exemption from Federal income tax provided the organization meets the following requirements (set forth in Rev. Rul. 75-298):

1. it is wholly owned and controlled by a foreign government;

2. its assets and income are derived solely from its activities and investments and from the foreign government;

3. its net income is credited either to itself or to the foreign government, with no portion of its income inuring to the benefit of any private person; and

4. its investments in the United States, if any, include only those which produce passive income, such as currencies, fixed interest deposits, stocks, bonds, and notes or other securities evidencing loans.

1/ U.S. Congress, House, An Act to Extend Certain Privileges, Exemptions, and Immunities to International Organizations and to the Officers and Employees Thereof, and For Other Purposes, Public Law 291, 79th Cong., 1st sess., 1945, H.R. 4489.

2/ Section 7701(a)(18) also defines the term "international organization" to mean "a public international organization entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organization Immunities Act (22 U.S.C. 288-288f)."

The same tests are applied for determining whether organizations are considered a "foreign government" for purposes of Section 893 (compensation of employees of foreign governments and international organizations).

2. Exemption from U.S. tax for compensation of employees of foreign governments and international organizations. Related and parallel to the exemption under Section 892 of the Code is the exemption contained in Section 893 which excludes from Federal income tax the compensation of employees of foreign governments and international organizations. Specifically, the exemption provides that wages, fees, or salary of an employee of a foreign government or of an international organization received as compensation for official services shall be exempt from tax provided:

1. such employee is not a citizen of the United States, or is a citizen of the Republic of the Philippines1/ (whether or not a citizen of the United States); and

2. in the case of an employee of a foreign government, the services are of a character similar to those performed by employees of the Government of the United States in foreign countries; and

3. in the case of an employee of a foreign government, the foreign government grants an equivalent exemption to employees of the Government of the United States performing similar services in such foreign country.

The Secretary of State is directed to certify to the Secretary of the Treasury those foreign countries which grant an equivalent exemption to the employees of the Government of the United States performing services in such foreign countries, and the character of the services performed by U.S. Government employees in foreign countries.

1/ A tax exemption for compensation of employees of the Commonwealth of the Philippines was introduced into the law in 1942. U.S. Congress, House, Revenue Act of 1942, Public Law 753, 77th Cong., 2nd sess., H.R. 7378, Section 149.

Section 893 first appeared in the Code in 1936,1/ and was amended in 1945 to include compensation paid to employees of international organizations.2/

When an organization has received an exemption under Section 892, the status of the organization is not in question for purposes of Section 893. Therefore, provided the additional requirements of Section 893 are met, individuals employed by such organizations will be exempt from Federal income tax with respect to the compensation received in performance of their official duties.

Generally, the exemption from Federal income tax of compensation of alien employees of foreign governments and international organizations is derived from the provision of Section 893. However, income tax treaties, consular agreements and international agreements also provide authority for the exemption from Federal income tax and are not dependent upon the provisions in the Internal Revenue Code. 3/

3. Exemption of foreign central banks from U.S. tax. Section 895 provides that income derived by a foreign central bank of issue from obligations of the United States or any agency or instrumentality thereof, or derived from interest on deposits, is exempt from taxation unless the obligations or deposits are used in the conduct of commercial activities. The exclusion does not apply if the obligations or bank deposits, from which the income is derived, are not owned by the foreign central bank of issue.

A "foreign central bank of issue"4/ is defined in the regulations as "a bank which is by law or government sanction the principal authority, other than the government itself, issuing instruments intended to circulate as currency".5/

1/ U.S. Congress, An Act to Provide Revenue, Equalize Taxation, and For Other Purposes, Public Law 740, 74th Congress, 1936, H.R. 12395.

2/ Public Law 291, 79th Cong., 1st sess., 1945.

3/ The application of these treaties and agreements is set forth in Rev. Rul. 75-425.

4/ Section 895 explicitly provides that the Bank for International Settlements will be treated as a foreign central bank of issue.

5/ Regulations 1.861-2(b)(4).

These banks are generally the custodians of the banking reserves of their countries and perform functions analogous to those performed by the U.S. Federal Reserve banks.

The tax exemption for income derived by a foreign central bank of issue was first enacted in 1961.1/ Prior to the enactment of Section 895, interest income derived by a foreign central bank of issue from bank deposits and banker's acceptances was treated as foreign source income and exempt from U.S tax.2/ An exemption was not provided for interest earned on U.S. Government obligations under Section 861, nor did the Service's interpretation of Section 892 provide such an exemption.

Section 895 was enacted to deal with the tax treatment of interest on U.S. Government obligations received by foreign central banks of issue where the banks were not part of the foreign government but were separately incorporated. The need for Section 895 arose as a result of conflicting interpretations of Section 892. Prior to 1946, the Service held that a foreign corporation, which was wholly owned by a foreign government, was exempt under Section 892 from tax on income from sources within the United States. In 1946, under pressure from the Joint Committee on Internal Revenue Taxation, the Service reversed its position and held that the tax exemption for a foreign government did not apply to a separate corporation.3/ The Service's position changed yet again as a result of its acquiescence to the decision rendered in the 1950 Louis Vial case.4/

1/ U.S., Congress, An Act to Amend the Internal Revenue Code of 1954 to Exempt from Tax Income Derived by a Foreign Central Bank of Issue From Obligations of the United States, and For Other Purposes, Public Law 87-29, 87th Cong., 1961, H.R. 5189.

2/ Section 861.

3/ Income Tax Ruling, 3789.

4/ Louis Vial, 15 U.S. T.C. 403 (1950). As a result of the Vial decision and reconsiderations the Service published Rev. Rul. 66-73, 1966-1, C.B. 174.

The Vial decision extended the Section 892 exemption to an entity which was wholly owned by a foreign government and which was so closely regulated, financed, and administered by the foreign government, that it would not constitute a "corporation" as the term is understood in the United States, but would instead be considered a part of the foreign government provided that its purposes and activities were exclusively national in scope. The enactment of Section 895 finally resolved the issue by providing an exemption for passive income derived by a foreign central bank of issue.1/

The tests applied in determining whether a foreign bank, which qualifies as a central bank of issue under Section 895, qualifies for the exemption from Federal income tax described in Sections 892 and 893 are the tests previously cited from Rev. Rul. 75-298. Under these tests, a central bank can engage in "commercial" transactions outside the United States yet not be disqualified from the Section 895 exemption.

1/ U.S., Congress, An Act to Amend the Internal Revenue Code of 1954 to Exempt from Tax Income Derived by a Foreign Central Bank of Issue From Obligations of the United States, and For Other Purposes, Committee Report on H.R. 5189, Senate Report No. 163, 87th Cong., 1st sess., 1961. Also see 1961-2, C.B. 351-353.

III. ECONOMIC SCOPE OF THE EXCLUSION

1. U.S. payments to official foreign institutions. Estimated total payments to official foreign institutions (including foreign central banks of issue) and international organizations exempt from U.S. withholding tax in 1976 amounted to approximately $5.6 billion (see Table 1). U.S. liabilities underlying these payments amounted to $95.8 billion (see Table 2). The average annual payments to official foreign institutions holding U.S. liabilities amounted to 5.8 percent of outstanding liabilities in 1976.

The geographic distribution of U.S. liabilities held by official institutions of foreign countries for 1970 through 1976 are presented in Table 3. The area of distribution of U.S. liabilities to official foreign institutions of foreign countries has changed markedly from 1970 to 1976. The proportion of liabilities to Western Europe fell from 57.3 percent in 1970 to 48.3 percent in September 1976, while the percentage of liabilities to Asia (including the Middle East) rose sharply from 19.8 percent in 1970 to 37.6 percent in September 1976. The share of U.S. liabilities to Canada and Latin America both registered decreases from 1970 to 1976.

The composition of U.S. liabilities to official foreign institutions has changed from 1970 to 1976, with the proportion of foreign official holdings of short-term Treasury bills and certificates generally declining, while the proportion of Treasury bonds and notes and other long-term liabilities has increased. There has been an overall decline in the proportion of all short-term obligations held by official foreign institutions in favor of long-term obligations.

2. Income receipts on U.S. Government assets abroad. In 1975 the U.S. Government received $1.1 billion in income on U.S. Government assets abroad (see Table 4). This income is primarily composed of interest realized on long and short-term credits extended by the United States to foreign countries.

The outstanding long-term principle indebtedness of foreign countries to the U.S. Government as of June 30, 1975, by area is presented in Table 5. The bulk of these credits have been extended under foreign assistance acts, the Export-Import Bank, and the Agricultural Trade Development and Assistance Act. Total outstanding long-term U.S. Government credits amounted to $34.5 billion as of June 30, 1975.

3. Compensation of government employees. Approximately 26,500 employees of foreign governments and international organizations working in the United States qualify for tax exemption under Section 893 (see Table 6). Wages, salaries, and fees received by these employees as compensation for official services amounted to an estimated $370 million in 1975 (see Table 6).

Table 1
Payments to Official Foreign Institutions
(Millions of Dollars)

Type of Liability	1970	1971	1972	1973	1974	1975	1976
Time deposits and other short-term bank obligations	436	236	237	646	1,118	931	739
Short-term Treasury bills and certificates	371	768	1,377	2,523	2,536	2,104	1,850
Short-term obligations payable in foreign currency	14	14	7	12	13	3	-
Marketable Treasury bonds and notes	23	32	192	375	369	353	755
Nonmarketable Treasury bonds and notes	227	289	497	976	1,259	1,155	1,394
Other readily marketable long-term liabilities	n.a.	n.a.	25	102	101	212	409
Liquid liabilities to non-monetary international and regional organizations	45	52	64	121	141	225	402
Stock in U.S. corporations	n.a.	n.a.	n.a.	44	n.a.	44	44
Total	1,116	1,391	2,399	5,581	5,537	5,027	5,593

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n.a. - not available

Table 2
U.S. Liabilities to Official Foreign Institutions 1/
(Millions of Dollars)

Type of Liability	Amount Outstanding at End of Period						
	1970	1971	1972	1973	1974	1975	1976 September
Demand deposits	1,652	1,327	1,591	2,125	2,951	2,644	2,548
Time deposits	2,554	2,039	2,880	3,911	4,257	3,423	2,144
Other short-term bank obligations	1,612	3,177	3,905	6,248	11,044	9,264	9,307
Short-term Treasury bills and certificates	13,367	32,311	31,453	31,511	34,656	34,182	35,653
Short-term obligations payable in foreign currency	148	165	171	127	127	--	--
Marketable Treasury bonds and notes	295	1,955	5,236	5,701	5,059	6,640	10,746
Nonmarketable U.S. Treasury bonds and notes	3,563	9,657	15,872	15,669	16,339	19,976	20,803
Other readily marketable long-term liabilities	695	144	543	1,673	2,346	4,521	5,816
Liquid liabilities to nonmonetary international and regional organizations	846	1,523	1,626	2,003	3,322	5,628	7,741
Stock in U.S. corporations	n.a.	n.a.	n.a.	n.a.	994	994	994
Total	24,732	52,298	63,277	68,968	81,095	88,644	95,752

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n.a. -- not available

Source: U.S. Department of the Treasury, Treasury Bulletin, (various issues).
U.S. Department of the Treasury, Foreign Portfolio Investment in the United States, August, 1976.

Table 3
U.S. Liabilities to Official Institutions of Foreign Countries by Area 1/
(Millions of Dollars)

Area	End of each calendar year 1970	1971	1972	1973	1974	1975	1976 (September)
Total foreign countries	23,775	50,651	61,526	66,827	77,659 2/	80,991 2/	87,010 2/
Western Europe	13,615	30,134	34,197	45,730	44,185	45,170	41,545
Canada	2,951	3,980	4,279	3,853	3,662	3,132	3,417
Latin American Republics	1,681	1,429	1,733	2,544	4,419	4,447	4,289
Asia	4,709	13,823	17,577	10,887	18,611	22,381	32,382
Africa	407	415	777	788	3,161	2,983	2,759
Other countries	413	870	2,963	3,025	2,627	1,894	1,624

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1/ Does not include liquid liabilities to nonmonetary international and regional organizations.
2/ Includes foreign official holdings of stock in U.S. corporations.

Source: U.S. Department of the Treasury, Treasury Bulletin, April 1976.
U.S. Department of the Treasury, Foreign Portfolio Investment in the United States, August 1976.

Table 4

Income Receipts on U.S. Government Assets Abroad 1/

(Millions of Dollars)

Year	Amount
1970	906
1971	887
1972	795
1973	828
1974	1,033
1975	1,119
1976	1,198 2/

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1/ Primarily interest realized on long and short term credits issued by the United States. Also included are interest earned on U.S. Government disbursing officers' deposits in commercial banks abroad; interest received on the holdings of official reserve assets by U.S. monetary authorities; interest on advances under other Exchange Stabilization Fund agreements; collections of commitment fees for foreign loans extended by U.S. Government agencies; service charges and other earnings from the U.S. investment in the International Monetary Fund; and net income of U.S. monetary authorities from day-to-day transactions in foreign currency exchanges.

2/ Estimate based on data from the first two quarters of 1976.

Source: U.S. Department of Commerce, Survey of Current Business, (various issues).

Table 5
Outstanding Long-Term Principle Indebtedness of Foreign Countries
on U.S. Government Credits as of
June 30, 1975 1/ by Area
(Millions of Dollars)

Area	Under Export-Import Bank Act	Under foreign assistance acts	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Loans of foreign currencies: To private enterprises	Long-term dollar credits	Lend-lease, surplus property & other war accounts	Commodity Credit Corporation export Credits	Other 2/ Credits	Total
Western Europe	2,439.0	430.6	353.5	-	177.6	584.8	19.2	2,675.2	6,679.9
Other Europe	227.1	29.0	-	-	-	693.5	291.1	-	1,240.7
Near East	1,045.8	2,897.5	565.3	15.1	487.1	23.3	90.5	114.0	5,238.6
South Asia	230.1	4,659.4	243.9	95.4	1,207.4	-	31.3	13.3	6,480.8
Africa	639.0	1,135.8	184.2	6.4	206.3	15.8	10.3	-	2,251.8
Eastern Asia and Pacific	1,923.5	1,318.3	51.5	3.6	1,454.2	231.6	146.7	33.1	5,162.5
Western Hemisphere	2,541.5	4,358.4	77.3	2.0	367.0	8.2	83.4	1.9	7,439.7
Worldwide	-	.4	-	.2	-	-	-	54.5	55.0
Total all countries and international organizations	9,046.0	14,829.4	1,475.7	122.7	3,953.6	1,557.2	672.5	2,892.0	34,549.1

Office of the Secretary of the Treasury
Office of Tax Analysis

June 7, 1976

1/ Exclusive of indebtedness arising from World War I.

2/ Primarily outstanding indebtedness of $2.6 billion under the Financial Agreement of December 6, 1945 between governments of the United States and the United Kingdom.

Source: U.S. Department of Treasury, Statistical Appendix to Annual Report of the Secretary of the Treasury on the State of the Finances, June 30, 1975.

Table 6
Employees of Foreign Governments and International Organizations
(Dollar amounts in millions)

	Number	Salaries e/
Diplomats assigned to embassies and international organizations	3,250	$ 81
Embassy employees	15,500	186
Consular officers	2,600	52
Consular staff	5,200 e/	52
Total	26,550	$371

Office of the Secretary of the Treasury
Office of Tax Analysis

September 8, 1976

e/ estimated

Source: U.S. Department of State, Office of the Assistant Chief of Protocol for Special Services.

The United States had 485,000 military personnel stationed abroad 1/ and approximately 40,000 federal civilian employees abroad in 1975. 2/ The estimated salaries of the federal civilian employees amounted to $740 million in 1975. Salaries of the 485,000 U.S. military personnel stationed in foreign countries amounted to approximately $3,930 million.

1/ U.S. Department of Defense, Office of Manpower Resources Affairs, Compensation Studies Group.

2/ Marcia Field and Brian Gregg, U.S. Taxation of Allowances Paid to U.S. Government Employees, this volume.

IV. THE EFFECT OF THE EXEMPTION ON TAX REVENUE

1. General rule. Present law, subject to numerous exceptions, calls for a 30 percent withholding tax on interest, dividends, rents, salaries, wages, premiums, annuities and other compensation paid to nonresident alien individuals and foreign corporations. 1/ This paper deals specifically with three statutory exceptions to this general rule; namely Sections 892, 893 and 895. A related statutory exception is the provision in Section 861 which provides an effective exemption for interest paid to nonresident alien individuals or foreign corporations on amounts deposited with U.S. banks, by virtue of the characterization of such interest as foreign source income. 2/ In addition, U.S. bilateral income tax treaties contain provisions which reduce or eliminate withholding tax on dividends and interest paid to treaty partners. 3/

2. Section 892: Exemption of foreign governments from U.S. tax. The estimated revenue cost associated with the $5 billion in dividend and interest payments made to foreign governments (including foreign central banks of issue) in 1975 was $630 million. 4/

1/ Sections 1441 and 1442.

2/ This provision was made permanent in the Tax Reform Act of 1976 (the provision had been periodically renewed since its first enactment in 1966).

3/ Income tax conventions with Belgium, Denmark, France, and Trinidad and Tobago specifically exempt from tax interest paid to the treaty government. The tax convention with Switzerland reduces the withholding rate on interest paid to either government to 5 percent. Generally, bilateral tax conventions which do not specifically exempt interest paid to either government contain provisions which reduce the withholding rate on dividends and interest paid to "residents" of the treaty country. While the term "resident" has not previously been interpreted to include the government of the treaty country, it could well be interpreted in this manner, in which case most treaties would substantially reduce withholding on dividends and interest paid to either government. In any event, the tax conventions could be altered by protocol to exempt income received by the treaty government.

4/ This estimate was made using treaty rates, when applicable, and excluding interest income on bank deposits covered by the effective exemption in Section 861. The underlying data are contained in Table 1.

3. Section 893: Exemption from U.S. tax for compensation of employees of foreign governments and international organizations. The revenue cost of this exemption is an estimated $87 million. The underlying data for this estimate are presented in Table 6. This estimate does not include diplomatic agents also exempt from tax under the "Vienna Convention". 1/

4. Section 895: Exemption of foreign central banks from U.S. tax. The revenue cost of this provision is included in the estimate for Section 892. This provision has induced a shift in the composition of portfolio holdings of foreign central banks of issue by removing the bias against holding U.S. Government securities. The shift is from other tax exempt assets to U.S. Government securities, made tax exempt by this provision.

5. Foreign government reciprocal exemptions. Net receipts on U.S. Government assets abroad would change little if foreign governments were to repeal their exemptions covering income paid to the U.S. Government. One reason is that U.S. income tax treaties contain provisions which would eliminate or reduce a substantial amount of the potential tax increase resulting from repeal of foreign statutory exemptions. Another reason is that most U.S. Government loan agreements specify that both principal and interest are free from tax and fees imposed by the borrower's country. To the extent that taxes and fees are imposed, the borrower is obligated to pay or reimburse the amount imposed. 2/ Hence, a net amount of interest must be paid to the United States regardless of the foreign tax treatment of this income. 3/ This is not the case with some of the older loan agreements which do not contain a provision specifically exempting the principal and interest from taxation.

1/ United Nations, Treaty Series, Treaties and International Agreements Registered or Filed and Reported with the Secretariat of the United Nations, Vol D (1961) No. 95, "The Vienna Convention on Diplomatic Relations", April 18, 1961. Entry into Force, April 24, 1964.

2/ Loans made under the foreign assistance acts, the Agricultural Trade Development and Assistance Act, and the Export-Import Bank Act contain provisions within the loan agreements which provide for a net payment, regardless of the foreign tax treatment of this income.

3/ While enforcement of the tax exemption has generally not been a significant problem, the Export-Import Bank has encountered minor obstacles in enforcing provision for certain loans made to private parties.

The revenue cost of the exemption from U.S. tax for compensation paid to employees of foreign governments and international organizations is small compared to the reciprocal exemptions granted U.S. Government employees abroad. U.S. military personnel in foreign countries are exempt from local income taxes under the "Status of Forces" agreements entered into by the United States and the host country. These agreements cover all U.S. military personnel abroad. The number of foreign military personnel in the United States benefiting from Section 893 is very small. There were 40,000 U.S. federal civilian employees abroad in 1975, compared to the 26,500 employees of foreign governments and international organizations in the United States.

V. ISSUES

1. Definition of "foreign governments". The first issue concerning the Section 892 exemption revolves around a precise test or definition for the phrase "foreign governments".

(a) Narrow approach. The approach could be taken that a foreign government or an integral part of a foreign government qualifies for an exemption under Section 892 only when the government is acting in its sovereign capacity with respect to its U.S. activities. The determination of sovereign capacity could be decided by the test of whether the foreign government's activities are governmental by United States standards. If this approach is taken, a foreign government would not qualify for the exemption under Section 892 for income derived from commercial activities. This approach circumvents the troublesome phrase, "or from any other source".

(b) Broad approach. An alternative approach would interpret the phrase "foreign governments" in Section 892 to include all organizations wholly owned and created by foreign governments regardless of the activities, structure or status of these entities. This interpretation would in effect broadly interpret the phrase "or from any other source".

(c) Intermediate approach. Between the narrow approach of allowing an exemption only for activities conducted by a foreign government when acting in its sovereign capacity, and the broad approach of allowing an exemption for all organizations wholly owned and created by foreign governments, lie numerous variations of these two extremes which could be adopted as the definition of the phrase "foreign governments".

2. Interpretation of "any other source". The second issue surrounds the intended scope of the phrase "or any other source". The original 1917 statute, which limited the exemption to investment income, clearly restricted the exemption to passive income. The 1918 amendment, which added the language "or from any other source" raised new questions as to the intended scope of the exemption. Is this phrase to be taken literally, or was the word "other" to mean other similar investments? If the phrase is to be taken literally, the exemption arguably would include income from any source, including non-passive (commercial) income. If the interpretation is to center on other similar investments, the scope would include passive income only. Even this narrow interpretation raises additional questions. For example, does rental income under a net lease arrangement qualify as passive income for purposes of Section 892, or should the receipt of such income be treated as a non-passive commercial activity?

No hard and fast lines have been drawn. In private letter rulings the Internal Revenue Service has held that certain cultural activities are not commercial, while it has viewed athletic events as commercial activities. There is some question whether a foreign government that has a controlling interest in a U.S. corporation is engaged in a non-passive commercial activity. Similar issues concerning the interpretation of "any other source" are likely to arise in the future.

VI. OPTIONS

1. Retain the exclusions in current law. This alternative, while minimizing the disruptions inherent in change, would not address the problems associated with certain aspects of the present exemptions. The granting of an 892 or 893 exemption is almost always done on a case-by-case basis. There are numerous unresolved issues surrounding these exemptions and the Internal Revenue Service's efforts at issuing specific guidelines have not kept up with the proliferation of nonconforming variations of foreign government activities. A satisfactory determination as to the scope of Section 892 has not been achieved, and until the language "from any other source" is interpreted by regulation or modified by statute, the Service will be hard pressed to justify either a broad, or a narrow interpretation of the exclusion.

Section 895 is acceptable in its current state and does not appear to warrant change.

2. Require reciprocal exemptions. While Section 893, the exemption of compensation paid to employees, requires that an equivalent exemption be granted to the employees of the Government of the United States, Section 892 requires no such reciprocity. The absence of a reciprocal provision in Section 892 encourages foreign governments and their agencies to extend the coverage of Section 892 whenever possible. One approach to this problem might be to require that an equivalent exemption be granted for both Sections 892 and 893. Requiring a reciprocal exemption does not, of course, ensure that the benefits derived will be equal for both parties. U.S. Government income flowing from foreign countries is minor compared to tax exempt income flowing from the United States to foreign governments. Consequently, a statutory equivalent or reciprocal exemption requirement would have little economic meaning for the United States.

Because of the special nature of employees of international organizations, their tax status perhaps warrants a different approach The country of citizenship of employees of international organizations might be given the exclusive right to tax. The special circumstances under which an employee of an international organization becomes a resident of the United States might provide justification for this departure from taxation based on the residence principle.

Further, the principle of "diplomatic immunity" provides a precedent for granting tax immunity under Section 893 to employees of international organizations. 1/

3. Limit the exemption to portfolio investment income. One alternative to current law is to amend Section 892 so that the exclusion is expressly limited to portfolio investment income. A statutory limitation to portfolio investment income should be coupled with a specific definition of portfolio investment.

This approach has certain drawbacks. The flow of benefits under this provision would continue to go to countries with substantial government investment in the United States. This approach would also continue to discriminate against foreign private investment in favor of foreign government investment. A more uniform approach was advocated by the Treasury Department in the context of the Tax Reform Act of 1976. The Treasury urged the repeal of withholding tax on dividends and interest paid to foreign individuals and corporations on portfolio investment. This broader approach, by comparison with an amended Section 892 approach, would not discriminate against private foreign investment in favor of foreign government investment.

4. Repeal the statutory exemption and rely on treaty exemptions. Repeal of the statutory exemptions under Sections 892 and 893 could be coupled with a treaty policy of negotiated exemptions (statutory repeal could be delayed for several years to allow time for treaty negotiations). Bilateral negotiations could ensure full reciprocity. However, as pointed out above, reciprocity would have limited economic significance for the United States. Specific governmental organizations qualifying for the exemption could be included and named in the treaty.

The inclusion of the tax exemption of foreign governments and their employees in bilateral income tax treaties, while providing a satisfactory approach to the taxation of foreign governments, does

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1/ The "Vienna Convention on Diplomatic Relations" of April 18, 1961, to which the United States is a party, provides, under article 34, that a member of the diplomatic staff of a mission is exempt (with some exceptions) from taxes, personal and real, national, regional or municipal. A diplomatic agent is not exempt from the following taxes under the Vienna Convention:
- indirect taxes incorporated in the price of goods and services;
- tax on private immovable property;
- estate, succession or inheritance duties; and
- taxes on private income having its source in the receiving States.

not provide an acceptable approach to international organizations. Nor does this approach answer the problem which would arise if the United States cannot satisfactorily conclude an income tax treaty with another country.

5. Repeal of the statutory exemption. This approach is only satisfactory if the objective is to discourage investment in the United States by foreign governments. If the current exemption were repealed, our treaty partners would press for protocols to existing income tax treaties in an effort to replace the repealed exemptions.

Appendix A

Tax Exempt International Organizations

The Food and Agriculture Organization
The International Labor Organization
The Pan American Union
The United Nations
Inter-American Institute of Agricultural Sciences
Inter-American Statistical Institute
International Bank for Reconstruction and Development
International Monetary Fund
Pan American Sanitary Bureau
International Wheat Advisory Committee (International Wheat Council)
The United Nations Educational, Scientific, and Cultural Organization
International Civil Aviation Organization
International Telecommunication Union
The Preparatory Commission for the International Refugee Organization
International Refugee Organization
International Cotton Advisory Committee
International Joint Committee--United States and Canada
World Health Organization
South Pacific Commission
Organization of American States
Organization for European Economic Cooperation
Inter-American Defense Board
Provisional Intergovernmental Committee for Movement of Migrants from Europe
International Atomic Energy Agency
Preparatory Commission of the International Atomic Energy Agency
Universal Postal Union
The International Hydrograph Bureau
Inter-American Development Bank
Coffee Study Group
The Caribbean Organization
Inter-American Tropical Tuna Commission
Great Lakes Fishery Commission
International Pacific Halibut Commission
International Coffee Organization
Asian Development Bank
European Space Research Organization
International Secretariat for Volunteer Service
United International Bureau for the Protection of Intellectual Property
Organization of African Unity
World Intellectual Property Organization

Source: Standard Federal Tax Reporter, 1976, Vol. 5, pp. 47203-47204.

STATE TAXATION OF INDIVIDUAL INCOME FROM FOREIGN SOURCES

Roy Blough

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I. INTRODUCTION

The free movement of goods, capital and ideas across state boundaries is a goal of national policy embedded in the U.S. Constitution and supported over the years by the courts and the Congress. Similarly, an objective of U.S. foreign policy in recent decades has been freer movement across national boundaries. These freedoms have facilitated the development of a truly national economy and, increasingly, an international economy.

For reasons of history and geography, governmental functions in the United States are divided among the national government, the fifty state governments, and thousands of political subdivisions. The financing of these political units has often involved taxing the stream of income generated by economic transactions. However, when numerous governments tap the same income stream, the result can easily be inequity and discrimination.

When an individual taxpayer lives continually in a single political jurisdiction and derives all his income from sources within that jurisdiction, only that jurisdiction can tax him; there is no danger of taxation by more than one government at the same "level" (local, state, or national). In a national and international economy, however, an increasing number of individuals derive their income from sources outside the jurisdiction in which they live. They are subject to the taxing power of the jurisdiction in which they live (the jurisdiction of "residence") and of the jurisdiction from which they derive income (the jurisdiction of "source"). Thus, if multiple and discriminatory taxation is to be avoided, there must be a division of taxing authority between the jurisdictions of residence and of source. 1/ Multiple taxation is not only inequitable, but it can also seriously impair the efficient functioning of a national or international economic system.

This paper examines the question of whether and to what extent states avoid discriminating against persons who derive income in whole or in part from foreign sources, who live abroad, or who are citizens or subjects of foreign countries.

1/ A closely related issue emerges when a business entity operates in two or more jurisdictions. See the essay by George Carlson in this volume, "State Taxation of Corporate Income from Foreign Sources".

The exercise of taxing power by the Federal Government is constrained by its own Constitutional requirements of due process and equal protection of the laws, and to a lesser extent by tax treaties with other countries. The states are constrained by Federal tax treaties, which can be written to take precedence over state constitutions and laws; by the Commerce and Due Process Clauses of the Federal Constitution 1/ and by statutes enacted in furtherance of those clauses; and by their own constitutions.

The rules followed by the Federal Government and by the different states in dealing with the geographical problem of taxation have a general similarity. There are, however, substantial differences in the rules from state to state, and between the state rules and those applying to the Federal income tax.

For the state, the two major international questions--(1) the taxation of residents of the state on the income derived by them from foreign (i.e., non-United States) sources and (2) the taxation of foreign residents on income derived by them from sources within the taxing state--are relatively minor parts of the larger questions of state taxation of residents on their out-of-state income (U. S. and foreign) and of the taxation of nonresidents (citizens and aliens) on their in-state income.

The relative importance of foreign source income in state personal income taxation does not appear in statistics published by the states. However, some light is thrown on the importance of foreign source income by tabulations from Federal income tax returns, since the foreign source income of resident individuals subject to Federal income tax is also an actual or potential object of taxation by at least one of the states.

While information on the amount of personal foreign source income on which foreign tax credit is claimed on individual Federal tax returns is not available, the dimensions are suggested by figures on the foreign tax credit itself, which are summarized in Table 1. This tabulation, based on a sample of returns, indicates that for 1974 the grand total of foreign tax credit claimed by individuals was about $292 million, or 0.2 percent of personal income tax liability (before tax credits).

Of the $292 million, 51 percent (about $148 million) was claimed by civilian citizens living abroad. Thirty-three percent (about $97 million) of the foreign tax credit was claimed by individuals filing in the 41 personal income tax states, 14 percent by taxpayers in the 9 non-income tax states, and the remaining 2 percent by persons filing from Puerto Rico and by overseas military personnel.

1/ Article I, Section 8 and Amendment XIV, Section 1.

More than one-third of U. S. citizens abroad filed returns claiming a foreign tax credit, while less than one-third of one percent of individuals filing in the 50 states claimed the credit. Clearly, foreign source income of individuals is not a major item in any state. But even small percentages can represent substantial amounts in total. The $97 million of foreign tax credit claimed by persons filing from income tax states must represent over $300 million of personal income. 1/ How much of the income of U. S. citizens living abroad might be taxable in the states is not readily estimated, but it may be conjectured that little, if any, is actually taxed by the states.

1/ The estimate of personal income is based on the assumption that average personal tax rates do not exceed 30 percent.

Table 1

U.S. FOREIGN TAX CREDIT, 1974: DISTRIBUTION BY STATES

State	Number of Returns: All Taxable Returns (Thousands)	Number of Returns: Returns Claiming Foreign Tax Credit	Number of Returns: FTC as % of Total	Tax and Credit: Income Tax Before Credits (Millions)	Tax and Credit: FTC Claimed (Thousands)	Tax and Credit: FTC as % of Personal Tax Liability	FTC per Taxpayer Claiming Credit
Total, 41 Income Tax States and District of Columbia	56,807	167,136	0.29	$ 104,865	$ 97,466	0.09	$ 583
Total, 9 Non-Income Tax States	10,503	29,461	0.28	19,663	41,612	0.21	1,412
Citizens Abroad	84	29,019	34.56	309	147,968	47.89	5,099
APO/FPO	298	943	0.32	227	7	* 0.00	7
Puerto Rico	16	6,632	41.22	15	4,680	31.20	706
Grand Total	67,708	233,191	0.34	$ 125,079	$ 291,733	0.23	$ 1,251
Total 50 States	67,310	196,597	0.29	124,528	139,078	0.11	711
SELECTED STATES							
New York (Y)	5,938	35,506	0.56	$ 11,805	$ 33,656	0.29	$ 931
Texas (N)	3,569	4,451	0.12	6,852	17,160	0.25	3,855
Florida (N)	2,635	13,459	0.51	4,818	13,480	0.28	1,002
California (Y)	6,963	39,651	0.57	13,136	15,684	0.12	396
New Jersey (Y)	2,482	9,114	0.37	5,338	8,942	0.17	981
Connecticut (N)	1,117	4,427	0.38	2,445	5,140	0.21	1,210
Michigan (Y)	2,893	7,147	0.25	5,765	4,754	0.08	665
Pennsylvania (Y)	3,904	8,712	0.22	6,970	4,594	0.07	527
Illinois (Y)	3,850	14,220	0.37	8,265	4,263	0.05	300
Mississippi (Y)	540	75	0.01	772	83	0.02	1,107
S. Carolina (Y)	832	715	0.09	1,161	104	0.01	145
S. Dakota (N)	188	202	0.11	304	35	0.01	173
West Virginia (Y)	499	370	0.07	828	34	* 0.00	92

Source: Unpublished data, Internal Revenue Service, Statistics Division, August 1976 (scheduled for release in early 1977).

Notes: FTC refers to Foreign Tax Credit.
Y refers to income tax state; N refers to non-income tax state.
* Less than 0.005

II. GROSS INCOME, EXCLUSIONS, DEDUCTIONS AND CREDITS

A net income tax is computed by starting with gross receipts and subtracting a succession of items--non-income receipts, exclusions, deductions, exemptions--to arrive at taxable income. A tax is then computed and tax credits are subtracted to arrive at the final tax liability. The computation of gross income and each of the successive subtractions involve the problem of allocation or apportionment of income and deductions to sources within the state (or country) and to sources without the state (or country). For convenience, the subject may be discussed in four related parts:

(1) definition of residents and nonresidents;

(2) exclusions from gross income of foreign source income;

(3) deductions of income taxes imposed by foreign countries;

(4) foreign tax credits.

1. Residents and nonresidents. Rules for defining residence are important because the state (or country) of residence is traditionally recognized as having the authority to tax the resident on his income from all sources, including out-of-state income. Conversely, a state is limited in taxing nonresidents to the taxation of income from sources within the state.

The Federal Government asserts the right to tax all U.S. citizens, resident or nonresident, on income from whatever source derived. Section 911 of the Internal Revenue Code allows certain exclusions to nonresident citizens, but these are a matter of legislative relief. The Federal Government also taxes resident aliens on income from all sources. Nonresident aliens are taxed only on income from sources within the United States.

U.S. citizens are assumed to be residents unless they demonstrate nonresidency. To demonstrate nonresidency, the citizen must establish that he has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year. "Whether a U.S. citizen is actually resident abroad shall be determined by the application, to the extent feasible, of the principles of...residence or nonresidence, as the case may be, in the United States in the case of an alien individual." (Regulation 1.911-2.)

A resident alien is defined in Regulation 1.871-2 as "an alien actually present in the U.S. who is not a mere transient or sojourner. Whether he is a transient is determined by his intentions regarding the length and nature of his stay." If the alien's visit is limited to a definite period by immigration laws, he is not a resident of the United States.

Each State has its own definition of residence and the definitions follow a number of different patterns. While there are limits beyond which the U.S. Constitution would prevent a state from successfully asserting tax jurisdiction on the basis of residence, considerable leeway exists.

According to the 14th Amendment to the Federal Constitution, a citizen of the United States is a citizen of the state in which he resides. Therefore, states are not able to use citizenship as a test of residency. Instead, in defining residence for state taxation purposes, the rough equivalent of citizenship is domicile. A person can have only one domicile at a time. To become domiciled involves both physical acts and mental determination, an intent to make the location "home". Although the place in which a person lives is taken to be his domicile unless contrary facts are adduced, no single factor controls the determination.

In all states a person who becomes domiciled in the state also becomes a resident of the state. In four states, domicile is the only criterion of residence and nonresidence. In the other 37 personal income tax states, a person having his legal domicile in the state may be considered a nonresident for income tax purposes because of extended absence from the state, establishment of a permanent place of abode outside the state, or for other reasons. In these 37 states, moreover, a person who is not domiciled in the state becomes a resident if he maintains a permanent abode, or otherwise lives in the state, usually for more than half of the taxable year.

The variations in defining residence for purposes of income taxation may result in some persons being taxed on their total income as residents by two or more states, while others may not be taxed as residents by any state. In 1965, the Advisory Commission on Intergovernmental Relations, recognizing the complications and inequities that result from disparate definitions of residence, recommended that the states adopt the following definition of resident:

"A resident individual means an individual:

(a) who is domiciled in this State, unless he maintains no permanent place of abode in this State, maintains a permanent place of abode elsewhere, and spends in the aggregate not more than 30 days of the taxable year in this State; or

(b) who is not domiciled in this State but maintains a permanent place of abode in this State and spends in the aggregate more than 183 days of the taxable year in this State." 1/

The Advisory Commission's definition uses the two terms "domicile" and "permanent abode". It avoids a third term used in state tax laws, namely, "abode". It also avoids using "temporary and transitory" which, along with other terms, appear in a few state laws. As of 1976, eleven states had adopted the Advisory Commission's language for defining resident. While the Advisory Commission's language represents a desirable step towards uniformity, it does not preclude double residence. An individual could be domiciled in one state and resident in another. Further, under the Advisory Commission 's language, an individual need not be a resident of any state.

When state law bothers to define nonresidence at all, it is taken to mean a person who is not a resident. In Georgia, there are non-taxable nonresidents and taxable nonresidents; the former category is limited to persons whose only income from the state is no more than five percent of the total compensation received by him for personal services. An individual who was a nonresident citizen for Federal purposes could very well be domiciled in a state and thus subject to full state taxation. This is not an imaginary problem. South Carolina has imposed taxes on foreign missionaries who were not in the State at any time during the year but had their legal domicile in the State.

To meet the problem that a person could be taxed as a resident in more than one state, the Advisory Commission recommended that state tax agencies be authorized to enter into reciprocal agreements to eliminate potential double taxation arising from dual or multiple residence. Four states have provided by law for elimination of double taxation in such cases through special crediting arrangements; others may achieve an equivalent result through administrative procedures.

1/ Advisory Commission on Intergovernmental Relations, Federal-State Coordination of Personal Income Taxes. October 1965, (Washington, D.C.), pp. 30-31.

An attempt was made in H.R. 977, which in 1968 passed the House of Representatives but not the Senate, to limit state taxation of residents to persons domiciled in the state. This bill was vigorously opposed by the Tax Commissioner of New York (among others) as too restrictive, contrary to 50 years of administrative practice, and in conflict with the recommendation of the Advisory Commission on Intergovernmental Relations. 1/

The United States Government also has a problem of dual residence in applying its income tax since different criteria of residence are used by different countries. The United States has endeavored to resolve this problem by securing adoption of the provisions of the U.S. Model Tax Treaty (October 1976), which establishes an order of priority among different criteria of residence. The first criterion to be considered is "permanent home": the individual is a resident of the country in which he has a permanent home. However, if the individual has a permanent home available to him in both countries or in neither country, he is deemed to be a resident of the country in which his personal and economic relations are closer (his center of vital interests). If his center of vital interests cannot be determined, he shall be deemed to be a resident of the country in which he has an habitual abode. If he has an habitual abode in both countries or in neither country, he shall be deemed to be a resident of the country of which he is a national. Finally, if the individual is a national of both countries or of neither country, the question of his residence is to be settled by mutual agreement of the competent authorities of the two governments.

2. Gross income for tax purposes. The individual income tax was imposed by some states (e.g., Wisconsin, in 1911) before the adoption of the 16th Amendment and the passage of the Federal income tax in 1913. The language of the pre-1913 state income tax statutes commonly differs from that of the Federal statute. The states that enacted income taxes subsequent to Federal law tended to follow Federal language. As tax rates increased at both Federal and state levels after World War II, there was great pressure to simplify the taxpayer's burden by making it possible for him to prepare his state (and municipal) tax return largely by reference to the Federal return.

1/ State Taxation of Interstate Commerce, Hearings Before the Subcommittee on State Taxation of Interstate Commerce of the Committee on Finance, U.S. Senate, 93rd Cong. 1st Sess., Sept. 18 and 19, 1973, p. 139.

By 1976, of the 41 state individual income tax laws, 32 states based the gross income of the state tax on the adjusted gross income reported for the Federal tax, with changes specifically enacted in the state law. For the most part, such changes are additions and subtractions necessitated by Constitutional considerations. Thus, interest on Federal securities would be subtracted, and interest on state and local securities would usually be added, for state income tax purposes. Personal compensation earned abroad which is exempted from the Federal tax base under Section 911 for persons absent from the country 17 out of 18 months would ordinarily be excluded for state income tax purposes. Of the 32 states basing their gross income on the Federal return, only three (Maryland, Massachusetts and Michigan) require adding back such income in computing the state tax base. Some states specifically exclude from state income taxation the constructive or "as if paid" income which is taxed by the Federal Government (e.g., the Subpart F income of a controlled foreign corporation which is not distributed as dividends), but most state laws do not mention the matter.

In the case of the nine states that do not base their gross income on the Federal return, a specific provision comparable to the Section 911 exemption would be necessary. None of the nine states provide such an exemption. Whether the excluded income is actually reported and taxed is another question.

3. Deductions and exemptions. Federal income tax law allows a taxpayer either to deduct income taxes paid to foreign countries from the Federal tax base or to credit foreign income taxes against his Federal tax liability. There is no requirement limiting the deduction to taxes on foreign source income. Foreign country taxes include taxes paid at the federal and subfederal levels. Most of the 32 "conforming" states that have adopted Federal gross income as the starting point for computing state income also use Federal deductions as a starting point. Certain deductions are disallowed, notably the deduction of state income taxes, and at least one state allows no deductions at all. In the absence of contrary language, the Federal deductions are presumably allowed by the conforming states in their own tax computations. Of the 32 conforming states, 23 made no mention of the deduction of foreign taxes, thereby allowing it for state income tax purposes, while 9 specifically disallowed it. Of the 9 "nonconforming" states, only one (Arkansas) permits a deduction for taxes paid to foreign governments.

Some conforming states have adopted the Federal schedule for personal exemptions, but the greater number have devised their own schedules. The exemptions do not have an international aspect, except as they are apportioned by the Federal Government in the case of nonresident aliens.

4. Foreign tax credit. In lieu of taking foreign income taxes as a deduction from income, the Federal taxpayer has the option, which is usually more favorable, of crediting the foreign income taxes against his Federal tax liability. Broadly speaking, the credit is limited to the amount of Federal tax that would otherwise be payable on the foreign source income.

States allow tax credits of their own to eliminate or reduce the double taxation that would otherwise result when income is taxed by both a resident state and a nonresident state. Every state except Alaska (which does not tax out-of-state income) allows a credit against its tax for all or part of taxes imposed on its residents by other states. Some states extend their tax credit to taxes imposed by the District of Columbia, the Commonwealth of Puerto Rico, territories and possessions of the United States, and in a few cases foreign governments.

The states differ as to the income on which the out-of-state tax must be imposed in order to qualify for the tax credit. The statutes of 18 states are silent as to the geographic source of income and the inference may be drawn that no source limitation is intended. The remaining 22 states require that the income be from out-of-state sources, and all but three of these require that the income be from sources within the state imposing the tax. These limitations are undoubtedly intended to avoid granting credit if the other state also claims the taxpayer as its own resident and taxes his total income.

The Federal foreign tax credit is specifically rejected as a credit against state income tax by a number of states, while most simply ignore it. Nine states extend their tax credit privilege to income taxes imposed by foreign governments, but usually not including taxes imposed by foreign local governments. 1/ Massachusetts limits its foreign tax credit to taxes imposed by the Canadian federal and provincial governments, but reduces creditable Canadian taxes by the amount of the U. S. Federal foreign tax credit. One state, North Dakota, allows the foreign tax credit to be added back to final Federal tax liability, which the state then allows as a deduction in computing its own income tax.

1/ The statutes of two additional states include "foreign governments" in their definitions of "state", but in one case the state's Attorney General and in the other case its Court of Claims have decided that the credit was intended only for taxes of other states.

A question not answered in most of the state laws is whether the individual taxpayer may deduct foreign taxes on his state return when he claims the foreign tax credit against his Federal income tax liability. It is assumed here that states which base their income on the Federal adjusted gross income and deductions permit the taxpayer to claim the foreign tax as a deduction for state tax purposes even though, for Federal tax purposes, the foreign tax credit is claimed instead of the deduction.

III. ALLOCATION AND APPORTIONMENT

1. Introduction. This section deals with the rules that are followed by the Federal government and by the state governments in assigning the income of individuals to different taxing jurisdictions when more than one can levy taxes with respect to the same income. This situation arises either when the "source" jurisdiction is not the same as the "residence" jurisdiction or when the activity which is the source of the income is carried on in two or more jurisdictions.

The terms commonly used for the assignment of income among jurisdictions are "allocation" and "apportionment". While these terms are often used interchangeably, there is a technical difference. Allocation refers to the assignment of a particular type of income to a single jurisdiction. Apportionment refers to the division of income among two or more jurisdictions.

The need to allocate or apportion a taxpayer's income between states, or between a state and a foreign country, does not arise if both the taxpayer and the source of all his income are entirely within (or entirely without) the particular jurisdiction. Nor does the need arise in computing the gross income, deductions, or exemptions of a resident taxpayer, since the state of residence (with the exception of four states) taxes his entire income from whatever geographical source it may be derived. Moreover, with respect to resident taxpayers, the need does not arise in computing the credit allowed for taxes imposed by other jurisdictions if the state of residence does not set limits on the source of income for which a tax credit is allowed. Eighteen of the 40 individual income tax states (leaving out Alaska) do not specify any limit on the source of income taxed by the other state. Of the nine states that allow a credit for foreign taxes, three do not specify any such limit.

The principal need for rules of allocation and apportionment in the state taxation of individuals arises in taxing nonresidents since they are taxed only on income derived from sources within the state. For nonbusiness income, this is ordinarily a matter of applying rules of allocation. Allocation may also be feasible in connection with a multistate trade or business, but more commonly state law specifies that the income of such business must be divided by apply apportionment factors.

A comparable need for allocation and apportionment arises for residents of the 22 states which limit the tax credit allowed for taxes imposed by another state or country to taxes on income having its source in out-of-state jurisdictions. Six of the nine states that allow a foreign tax credit limit it to taxes on income from sources within the foreign country. Some states (e.g., New York) specify that the computation of tax credit for income taxed in other states or countries shall follow the same rules of allocation and apportionment as that jurisdiction itself follows in the case of nonresidents. Other states do not specify rules. Presumably these states either apply the same rules that they apply to nonresidents, or they accept without challenge the allocation and apportionment rules used by the other state.

Alaska, as a special case, uses allocation and apportionment rules with respect to the income of both residents and nonresidents. Out-of-state income is exempt from Alaskan tax.

The Federal need for allocation and apportionment rules is much the same as that of any state, with a few variations. The Federal government taxes U.S. citizens and residents on both foreign and domestic income. There is no need for allocating such income, with the exception of up to $15,000 of personal service income that may be excluded under Section 911 (as amended by the Tax Reform Act of 1976) because of the recipient's extended absence from the United States. The taxpayer's claim that this income was foreign source would need to be confirmed. In addition, foreign source income must be computed for purposes of establishing limits on the foreign tax credit.

2. Types of income. Generally, allocation and apportionment rules are keyed to the type of income. The Federal rules depend on the characterization of income as wages, rent, interest, royalties, dividends, gain from the sale of property, and so forth. The state rules often depend on the distinction between business and nonbusiness income, a distinction unknown to Federal tax law. In making this distinction, neither the service given in exchange for the income payment nor the name given to that payment--for example, wages, rent, interest, royalties, dividends, gain from the sale of property--is significant. What is significant is whether the item of income is received as one of many similar items by a going business operation; if so, the payment is business income, otherwise it is nonbusiness income. Thus, a going business concern can receive both business income and nonbusiness income.

The following paragraphs describe the allocation rules employed by states in dividing nonbusiness income between taxing jurisdictions, and the Federal rules for dealing with comparable types of income.

(a) Compensation for Personal Services.

(i) Federal tax law. Compensation for personal services performed in the United States is income from United States sources.

There is a minor exception to this rule: a nonresident alien present in the United States for not more than 90 days and receiving compensation not exceeding $3,000 from foreign offices of a domestic corporation, or from nonresident aliens or corporations that are not engaged in trade or business in the United States, is treated as not receiving income from U.S. sources.

(ii) State tax law. Compensation for personal services performed within the state is state income. At least one state has an exception for nonresidents receiving minimal compensation for personal services rendered in the state. This exemption corresponds to the nonresident alien exception of the Federal government.

(b) Income from real estate.

(i) Federal tax law. Rentals received from the use of real property located within the United States and gains from the sales of such property are income from U.S. sources.

(ii) State tax law. State rules are comparable to those of the Federal government. Rentals from the use of real property located within the state and gains from the sale of such property are taxed to nonresidents as income from sources within the state.

(c) Income from tangible personal property.

(i) Federal tax law. Rentals received from the use of tangible personal property located within the state and gains from the sale of such property are income from U.S. sources. Gains from the sale in the United States of personal property purchased outside the United States are income from sources within the United States. Gains from personal property purchased within the United States and sold outside the United States are income from sources outside the United States. (See the special rule in Section (g) dealing with property produced within and sold outside the United States and vice versa.)

(ii) State tax law. Rentals from the ownership of tangible personal property located within the state and gains from the sale of such property are taxable to nonresidents as income from sources within the state.

(d) Royalties from "intellectual property".

(i) Federal tax law. Royalties for the privilege of using patents, copyrights, processes and formulas, trademarks, trade brands, franchises, and like property within the United States are U.S. source income. Conversely, royalties for using intellectual property outside the United States are foreign source income.

(ii) State tax law. The state rules regarding royalties are comparable to the Federal rule. Some states provide that if the place where such property is used cannot be determined, the income is to be allocated to the "commercial domicile" of the taxpayer.

(e) Interest.

(i) Federal tax law. Interest is treated as income from sources within the United States if it is received from the U. S. Government, any state, territory, or political subdivision, or the District of Columbia. (Interest on securities of the states and their political subdivisions are exempt from Federal tax.) Further, interest on bonds, notes, and other interest-bearing obligations of corporate and other U. S. residents are U. S. source income. Special source rules are provided for interest paid by certain corporations doing business both within and outside the United States. These rules characterize as U. S. source income that portion of the interest which reflects the proportion of gross income of the corporation derived from business conducted within the United States.

(ii) State tax law. The state allocation rules for interest diverge sharply from the Federal rules. Interest income is usually allocated to the state of residence of the recipient. Thus, interest income is generally not taxed by a state when paid by a resident to a nonresident. An exception is made for interest income connected with business carried on within the state by a nonresident; in that case the interest is allocated to the state.

(f) Dividends.

(i) Federal tax law. If the income from which the dividend was paid was earned in the United States, the dividend is from U. S. sources. In the case of a domestic corporation, dividends are considered to be from U. S. sources unless less than 20 percent of the gross income of that corporation is derived from sources within the United States. In the case of foreign corporations, dividends are from sources outside the United States unless 50 percent or more of the corporation's gross income is connected with conduct of trade or business within the United States. In that case, the proportion of the corporation's income from the conduct of trade or business within the United States determines the proportion of the dividends characterized as income from sources within the United States.

(ii) State tax law. State allocation rules for dividends diverge sharply from Federal rules. The states allocate dividends (like interest) to the residence of the taxpayer unless the dividends are derived in connection with a business carried on within the state by a nonresident.

(g) Business income.

(i) Federal tax law. While Federal tax law does not distinguish business income from nonbusiness income, it prescribes rules for allocating and apportioning items of income, deductions, and losses in situations which would give rise to business income for state income tax purposes.

Probably the major category of such income is income derived from the sale of personal property that is produced in whole or in part by the taxpayer within the United States and sold outside the United States, or produced by the taxpayer outside the United States and sold within the United States. In determining the source of such income the regulations set out three examples.

(1) In the first example, the producer regularly sells part of his output to independent distributors or other selling concerns. Accordingly, a fair and accurate price can be ascertained. The producer also sells part of his ex-factory output to controlled distributors abroad. Income from sources within the United States is computed by an accounting method which treats the transfer of products from the production department of the business to the foreign distributors as sales at the established ex-factory price. The profits of production are thereby separated from the profits of selling, each part being allocated to the country in which the activity took place.

(2) In a second example, no independent factory price has been established. In this case the expenses and losses are deducted from the total income to determine total taxable income. One-half of the taxable income is divided between U.S. and foreign sources in proportion to the value of the taxpayer's property in the United States and the value of his property within the foreign country. The other one-half is apportioned in proportion to the taxpayer's gross sales in the U.S. and in the foreign country.

(3) In the third example, the taxpayer may base his tax return on his books of account if he is acting in good faith, unaffected by considerations of tax liability, and regularly allocates receipts and expenditures in a manner which reflects more clearly than the two methods previously described the taxable income derived from sources within the United States.

In applying these rules the Internal Revenue Service is empowered to correct transfer prices between related parties and to allocate and apportion expenses to income from U.S. and foreign sources.

In the case of transportation and certain other services, the regulations in effect divide the income in proportion to expenses and provide that a reasonable rate of return shall be earned on property used within the United States.

In the case of telegraph and cable services, the gross revenues derived from messages originating in the United States are income from U.S. sources, while gross revenues collected from messages originating outside the United States are income from foreign sources.

(ii) State tax law. For the most part, the rules for dividing income among taxing jurisdictions are the same for corporations and nonresident individuals. However, in a few states different rules are specified for corporations and individuals, and some states with personal income taxes have no tax on corporation net income. States sometimes require the consolidation of incomes of affiliated corporations, applying unitary assessment and apportionment rules to the consolidated whole.

The usual method of dividing the income of a business carried on both inside and outside the state is to treat the business as a unit and to apportion the total income between jurisdictions by formula. The great majority of the states use a 3-factor formula, giving equal weight to tangible property, sales, and payrolls within the state in relation to company totals of these factors. State regulations often provide detailed definitions of property, sales, and payrolls.

Some states have other apportionment formulae. For example, Colorado has a 2-factor formula, one-half property, one-half gross receipts. 1/ A few states (e.g., Mississippi) specify allocation by means of separate accounting when feasible, and fall back on the use of apportionment factors when separate accounting is not feasible. In some states the tax administrator may issue administrative rules and regulations governing allocation and apportionment, and in at least a few states it appears that allocation and apportionment are dealt with on a case-by-case basis.

Many state laws specify that at the initiative of the administrator, or of the taxpayer with approval of the administrator, methods of allocation and apportionment can be modified by adding factors, subtracting factors, using separate accounting, or otherwise seeking to achieve the most equitable division of income among taxing jurisdictions.

1/ However, Colorado has adopted the Multistate Tax Compact, which gives the taxpayer the option of using the standard 3-factor apportionment formula.

IV. STEPS TOWARD NEEDED UNIFORMITY IN INCOME DEFINITION AND MEASUREMENT

1. Uniformity among the states. The evolution of markets and firms from local to regional to national and finally to international in scope has made tax uniformity increasingly important. One obstacle to uniformity and cooperation among the states is inertia. Beyond this, the states wish to maintain their independence of action in an economy with broader and broader markets. Each state would like to design rules for allocation and apportionment that will produce the greatest revenue for the state from the particular industries dominating its multistate business. In the absence of limiting Federal legislation, the U. S. Supreme Court has usually approved allocation and apportionment rules if they showed an element of rationality, regardless of the possibilities of multiple taxation.

There are of course motives for states to seek greater uniformity in the taxation of multistate business. Among these are the direct pressures of taxpayers on state legislatures, the desire of states to ease interstate conflicts, the possibilities of more effective administration, and the prospect of less expensive audits through cooperative programs. However, the principal reason for state action toward uniformity has been the fear that taxpayers would bring pressure to bear on Congress, resulting in Federal laws limiting the jurisdiction and freedom of states to tax multistate business.

Efforts to develop uniform rules in the field of manufacturing and trade date back to the 1920's and 1930's when the National Tax Association, as well as other organizations, had committees at work on the matter. The 3-factor apportionment formula with equal weights for property, payrolls, and sales (sometimes called the "Massachusetts Rule") emerged from these discussions as a relatively equitable method when the unitary character of the business made separate accounting impracticable.

There is a large degree of uniformity among the states in the statutory allocation of nonbusiness income. The principal complaints of taxpayers were against the variations in allocating and apportioning business income. To encourage greater uniformity a committee of the Council of State Governments in 1958 recommended a Uniform Division of Income for Tax Purposes Act (UDITPA) that in effect codified the prevailing allocation rules for nonbusiness income and the 3-factor apportionment formula for business income.

Even this approach did not bring uniformity, and the states became alarmed that Congress would exercise its powers under the Commerce Clause, limiting the scope of state taxation. In 1959 the U. S. Supreme Court upheld state power to tax sales within the state by out-of-state business even when there was no business establishment in the state. Congress promptly passed a law (Public Law 86-272) removing many sales activities from state and local taxing jurisdictions and providing for a committee to study the state and local taxation of multistate business. This committee (the Willis Committee) presented a report to Congress in early January 1967. The accompanying bill, which was not enacted, would have restricted the jurisdiction of state and local governments in their taxation of income. Other bills have also been introduced to prevent nonuniform, overlapping state and local taxes.

With the threat of Congressional action, a widely representative group of state officials developed the Multistate Tax Compact (MTC), which was announced in final form in December 1966. During the first seven months of 1967 twelve states enacted the Compact and a few more have done so in subsequent years. The Compact relates primarily to types of taxes paid by business firms. In form it is a state law, part or all of which may be adopted. It contains the UDITPA and specifies that a taxpayer in a state adopting the relevant section of the Compact has the option of using its 3-factor apportionment formula and other provisions instead of those otherwise provided in the state tax laws. The interstate compact elements consist of establishing a Multistate Tax Commission to deal with non-self-executing provisions, particularly in connection with provisions for arbitration of disputes. It was also anticipated that the Compact would make single audits possible. There is little indication in the UDITPA or the MTC that the committees developing them gave thought to the the taxation of foreign source income.

The Multistate Tax Commission is a going concern, with offices in Denver, Colorado. Although the U.S. Constitution provides (Art. I, Section 10) that "no state shall, without the consent of Congress...enter into any agreement or compact with another state..." the sponsors of the Multistate Tax Compact decided that Congressional approval was not necessary.

For corporation income tax purposes, 16 states have adopted the MTC with its provisions for UDITPA, and at least three additional states have adopted UDITPA but not MTC. 1/ Thus, only 19 out of 41 personal income tax states have accepted this measure of uniformity and cooperation, although many of the others follow similar rules for allocation and apportionment.

1/ Advisory Commission on Intergovernmental Relations, <u>1974-75 Edition, Federal-State-Local Finances: Significant Features of Fiscal Federalism</u> (Washington, D.C., November 1975). At least two states (Alabama and Mississippi) adopted the Compact, contingent on Congressional approval, which apparently has not been sought.

Taxpayer pressures for Federal legislation have continued. Extensive hearings were held by a subcommittee of the Senate Finance Committee in 1973 on several bills. 1/ One of these (S. 2092) would have given Congressional authorization for the Multistate Tax Compact, but would have restricted in a number of respects the powers of the states to impose income taxes on multistate business. Another bill (S. 1245) would, according to its title, have provided "a system for the taxation of interstate commerce" by the states. One of its provisions (Sec. 207) would have excluded from apportionable income "income from sources without the United States". Representatives of states and of organizations of state officials vigorously objected to the bills, and no legislation has thus far been enacted on the subject.

1/ State Taxation of Interstate Commerce, Hearings Before the Subcommittee on State Taxation of Interstate Commerce of the Committee on Finance, United States Senate, 93rd Cong. 1st Sess., Sept. 18 and 19, 1973.

V. OPTIONS

1. Introduction. There continues to be substantial political pressure by taxpayers for Federal legislation to increase the uniformity, equity and neutrality of state taxation of multistate and multinational income. The complaints are directed mainly at double taxation of multistate income and, at the multinational level, chiefly relate to the taxation of corporations and their foreign affiliates. However, the complaints regarding the tax treatment of individuals on their foreign source income also merit consideration.

The Federal Government would presumably have two purposes in the imposition of limitations on states with respect to their taxation of foreign source income: (1) to bring state taxation of foreign source income into closer harmony with the rules of Federal taxation in order to simplify taxpayer compliance, and to avoid diplomatic and commercial irritation to foreign countries; (2) to bring state taxation of foreign source income into closer harmony with state taxation of in-state income and income from other states.

Taxation of the same income by two or more jurisdictions at the same level (national, state or provincial, or local) would violate equity and neutrality tests, in the absence of some method of preventing double taxation. The result of double taxation is to deter firms and individuals residing in one jurisdiction from earning income in another jurisdiction. Double taxation serves to isolate markets and limit the scope of competition. This result is contrary to national goals.

Double taxation can be avoided by exemption, allocation and apportionment, or by a credit for taxes imposed by another jurisdiction. Double taxation can be reduced by allowing a deduction of the tax imposed by one jurisdiction from the income base of another jurisdiction. The Federal tax law uses all four methods in taxing foreign source income. The major reliance is on the foreign tax credit. The policy objectives underlying Federal taxation of foreign source income are:

(1) that the jurisdiction where the income has its source is entitled to priority in taxing that income;

(2) that a U. S. taxpayer should not be discouraged from engaging in economic activity abroad by being fully taxed by both foreign and U. S. jurisdictions; and

(3) that U. S. taxpayers should not be taxed in total more heavily on domestic source income than on foreign source income.

To achieve these results the Federal tax on citizens and alien residents is imposed on both domestic source and foreign source income and a foreign tax credit is allowed. The foreign tax credit is limited in such a way that the taxpayer is in effect subject to the higher of the U. S. tax or the foreign tax. 1

While the objectives underlying the foreign tax credit have been criticized, they have been the consistent Federal policy for more than half a century. State and local income taxes are part of the U. S. system of taxing income. It is arguable that the implementation of the Federal objectives requires that the taxpayer should not be subject to higher total income taxes than the higher of the combined Federal and state (and local) income taxes or the foreign income taxes (federal and subfederal) on the same income.

A second way to look at the matter is to accept the objective that states should not tax income from foreign sources any higher than they tax income from other states, which in turn should not in total be taxed higher (except as the other state may impose higher taxes) than income from in-state sources.

With these considerations in mind, a number of possible Federal alternatives are discussed in the following sections, including; (1) take no action; (2) forbid state taxation of foreign source income; (3) limit state taxation to foreign source income as the term is defined by Federal tax law; (4) require a state foreign tax credit similar to the Federal foreign tax credit; and (5) require a state deduction of foreign income and property taxes similar to the Federal deduction for foreign taxes (Section 164, as limited by Section 275).

2. No Congressional action. Some states favor Congressional action which would permit states voluntarily to accept the Multistate Tax Compact pattern of allocation and apportionment as well as joint action in audit and dispute settlement. Other states fear even this much Congressional control over state tax jurisdiction. There appears to be universal opposition by state tax administrators to Federal restrictions on state taxation.

1/ The progressive rates of the individual income tax often result in foreign source income adding U. S. tax in excess of the foreign tax credit limit.

The only reference in the Multistate Tax Compact to foreign source income is to include foreign countries as "states" for purposes of allocation and apportionment. Thus, whether or not the MTC is endorsed by Congress, there would be little effect on state taxation of foreign source income.

In support of the alternative of taking no Federal action to limit state taxation is the maintenance of a viable Federal system as a major national goal. Since only a small fraction of individual taxpayers receive foreign source income and since the burden added by state taxation is reduced by its deductibility from income for Federal tax purposes, it can be argued that Congress should not intrude when state tax practices do not pose a major threat to the free movement of people, capital, and goods. Against taking no action is the consideration that the difference in treatment of foreign source and domestic source income by the states can in particular cases be substantial. Moreover, the best time to deal with a potential problem may be at the early stages.

3. Forbid state taxation of foreign source income. Some proposals would have the effect of prohibiting states from taxing the foreign source income of corporations, including dividends from foreign subsidiaries. Whatever may be the merits of this proposal with respect to corporations, it could not be taken seriously with respect to the taxation of individuals. The Federal Government taxes citizens and resident aliens on their foreign source income. To deny the states the same right to tax the income of resident individuals would be inconsistent and might result in less total tax being paid on the foreign source income than on the U. S. source income of the same taxpayer.

4. Conform the state definition of foreign source income to the Federal definition and require a uniform definition of residence for state tax purposes. A partial approach to creating greater uniformity between Federal and state taxation of foreign source income would be to limit foreign source income taxable by states to such income as it is defined for Federal income tax purposes, and to require a uniform definition of state tax residence. This alternative would deal only with the definition of foreign source income and state tax residence. It would not deal with problems raised by differing tax treatment of foreign source income.

This alternative would lead to a unique assignment of residence to each individual for state tax purposes. No individual would be taxable, as a resident, by more than one state. In addition, this alternative would result in a mandatory exclusion of $15,000 of wage or salary income earned abroad. Further, a state allowing a foreign tax credit would be obliged to consider dividends and interest received from foreign sources by residents as foreign source income for the purposes of computing the credit. At present, the states generally allocate dividends and interest to the state of residence, thereby excluding them from a foreign tax credit computation.

The apportionment of business income through unitary assessment applying a 3-factor formula (sales, payroll, property), which has become nearly universal in state practice, can result in a different division of income between domestic sources and foreign sources for state and Federal tax purposes. Under this approach, the Federal definition would control, but states could continue to use the formula apportionment for dividing income among themselves. This change would affect both the state foreign tax credit and the taxation by the states of the income of nonresident individuals and corporations.

This alternative would significantly promote uniformity between the states and the Federal government. However, it would not necessarily promote uniformity in the state taxation of in-state, out-of-state, and foreign source income.

5. Require states to allow resident individuals a foreign tax credit. Nine states allow resident individuals to claim a foreign tax credit against their state income taxes. At least two of the nine require that the Federal foreign tax credit must first be subtracted from foreign income taxes before the state credit is applied. In case the foreign income taxes are entirely offset by the Federal tax credit there would be no state credit and the state tax would be payable in full. This treatment appears to be conceptually correct on the theory that double taxation occurs only when the total tax on foreign source income exceeds the higher of foreign income taxes (federal and sub-federal) on the one hand or the combined total of U. S. Federal and state income taxes on the other. Thus, states should at most be required to provide a credit for excess foreign taxes (individual states could, of course, provide a higher credit if they wished).

In states which allow a foreign tax credit without regard to the Federal foreign tax credit, the state credit would ordinarily eliminate the state tax liability, given the prevailing levels of foreign income and withholding tax rates and state income tax rates. For example, if the foreign tax rate was 40 percent, the Federal tax rate was 40 percent, and the state tax rate was 10 percent, the taxpayer would pay only the foreign tax, being freed by the foreign tax credits from both the Federal tax and the state tax.

If the state foreign tax credit is limited to the excess of the foreign income tax over the Federal foreign tax credit, the combined taxes on foreign source income would not be reduced below the combined taxes on domestic source income. Further, there would be no state tax on foreign income to deduct from Federal taxable income if the foreign income was already taxed at a rate no lower than the combined domestic rate. Thus, revenue of the Federal Government would be somewhat greater than if the state did not provide any foreign tax credit. Conversely, revenues of those states which do not presently allow a foreign tax credit would be reduced somewhat. Revenues of those states which now allow a foreign tax credit without a limit as to excess taxes would be increased, if those states conformed to the excess foreign tax rule.

6. Require state deduction of foreign taxes from state taxable income. It appears that 25 of the 41 states taxing individual incomes allow foreign income taxes as a deduction from state taxable income. One alternative open to Congress would be to require that all states allow such a deduction, and extend the deduction, as in Federal law (Section 164) to cover foreign real property taxes.

The quantitative effect of deduction or nondeduction by states of foreign income and property taxes paid by resident individuals would depend on the rate of the foreign tax, the marginal rate and the average rate of the Federal income tax, and the marginal rate of state income tax, as well as on whether the state allows the Federal income tax as a deduction from state taxable income. The possible permutations and combinations of rates are too numerous to justify exploring all of them, but one example will indicate the type of calculation involved.

It is assumed that the individual taxpayer receives, in addition to his in-state income, $1,000 of foreign source income. The purpose of the example is to show the effects on the state tax, the Federal tax, and total income taxes (foreign, Federal, and state) under five assumed conditions: (1) no state tax, which is used as a base for computing percentage increases in tax under the other three conditions; (2) a state tax in which neither foreign nor Federal taxes are allowed as a deduction; (3) a state tax in which foreign income taxes are deducted but the Federal tax is not; (4) a state tax in which both the foreign income tax and the Federal tax are deducted; and (5) a state in which the Federal tax is deducted and the foreign tax is not deducted.

The foreign income taxes imposed on U. S. resident individuals vary widely. An individual receiving interest or dividends from some European countries may have no foreign income tax, while the tax on royalty income from Australia, for example, may be as high as the full rate imposed on the income of the corporation paying the royalty. Earned income and profits of personally owned businesses may be subject to rates ranging from perhaps 15 percent to 70 percent or even higher, depending on the size of the income and the country where it is earned.

In the example it is assumed that the foreign income tax on $1,000 is $200 (average rate 20%), the state income tax marginal rate is 10 percent, the Federal income tax marginal rate is 40 percent, and the average Federal income tax rate and foreign tax credit limit is 30 percent. The interlocking effects are shown in Table 2.

Table 2

EXAMPLE OF ADDITIONAL TAX DUE TO THE RECEIPT OF $1,000 OF FOREIGN SOURCE INCOME

Assumption	Foreign Tax 20%	State Tax 10%	Federal Tax (after foreign tax credit)*	Taxpayer's Total All taxes	% Added by State Tax
No State Income Tax	$200	$0	$200	$400	---
State Income Tax With: Foreign tax not deducted Federal tax not deducted	200	100	160	460	+ 15%
State Income Tax With: Foreign tax deducted Federal tax not deducted	200	80	168	448	+ 12
State Income Tax With: Foreign tax deducted Federal tax deducted	200	63	175	438	+ 9.5
State Income Tax With: Foreign tax not deducted Federal tax deducted	200	83	167	450	+ 12.5

* Foreign tax credit limit assumed to be $300

APPENDIX A

TABULATION OF STATE INCOME TAXATION OF RESIDENT AND NONRESIDENT INDIVIDUALS ON OUT-OF-STATE INCOME

1. Introduction. The basic source of information was the Commerce Clearing House Tax Reports for the different states. The most relevant information has been summarized in four tables. It is believed that the tables present a generally accurate picture of the patterns of state taxation of multistate and multinational income of individuals. The information relating to any particular state, however, is subject to error. Relevant statutory provisions may have been overlooked. Administrative regulations sometimes interpret statutes in unexpected ways, and some regulations may not have been included in the CCH Tax Report. Court decisions may have invalidated or modified statutory provisions. 1/

Table A-1 shows the criteria which the various states use in defining "resident". It also indicates the sources of taxable income and types of deductions that are relevant to the tax treatment of foreign source income and other out-of-state income of resident individuals. Table A-2 presents the conditions and limitations under which residents are allowed to credit against the state income tax the income taxes imposed by other states and foreign jurisdictions. Table A-3 presents for nonresidents information comparable to that presented for residents in Tables A-1 and A-2. Table A-4 summarizes rules for the allocation and apportionment of income that has its source both inside and outside the state.

1/ For these reasons, the tables are put forward with the hope that corrections and elaborations will be received from state tax administrators, tax attorneys, accountants, and other informed persons.

Table A-1

STATE INCOME TAXATION OF RESIDENT INDIVIDUALS:

A. Residence Criteria, Gross Income, and Deductions

Descriptions of the contents of the numbered columns are as follows.

(1) State. As of June 30, 1976, 41 states and the District of Columbia imposed net income taxes of a general character. These are the only jurisdictions included in the tables. States imposing taxes on gross income and taxes on specific income sources, for example, income from interstate commuters, are not included in the study.

(2) Federal Tax Base. "Yes" in this column signifies that the state income "conforms" to the Federal income tax by adopting Federal adjusted gross income as the starting point in the computation of the state income tax base. "No" signifies that the state income tax law is silent on the point, which means that it does not "conform".

In the conforming states, the Federal rules with regard to the treatment of foreign source income and foreign income taxes are presumably followed by the state (in the absence of a contrary provision). Some states go further than others in adopting Federal deductions, exemptions, credits, and even in a few cases, tax rates. Other states limit their modification of Federal tax law to those necessitated by the Constitution or Federal statutes, while certain other states introduce various provisions with a view to achieving desired state policy objectives.

(3) Residence Criteria: Domicile Test. Resident and nonresident individuals are taxed differently. In all states a person who becomes domiciled in the state becomes a resident for tax purposes. Whether a person is domiciled in a state is a question of intent as well as physical circumstances. Some states permit a domiciled individual to lose his tax status as a resident by extended absence. Provisions of law to this effect are indicated in the footnotes.

(4) Residence Criteria: Permanent Abode Test. Many states also treat as residents for tax purposes individuals who are not domiciled in the state but have established a permanent abode there. "Yes" signifies these states, most of which do not claim that the individual is a resident unless he is in the state for more than a certain part of the year, as indicated in the footnotes.

(5) Residence Criteria: Six Months Test. With few exceptions those states which do not require domicile or permanent abode as necessary criteria for residence treat the individual as a resident for tax purposes if he is in the state for part of the year, usually for more than half of the year. "Yes" signifies these states. States that designate some fraction of the year other than six months as the criterion are indicated in the footnotes. In some states the test is simply whether the presence of the individual in the state was "temporary" or "transitory"; if so, he is not treated as a resident.

(6) Taxable Gross Income: Income Sources and Types. Two criteria for determining what income is subject to taxation are: its geographic source (in-state or out-of-state) and its character (wages, interest, business profits, etc.). "All" signifies that the resident is taxable on income from all geographical sources and all types. Alaska taxes only income from sources within the state, and a few states do not tax residents on specific types of income from out-of-state sources, as indicated in the footnotes.

(7) Taxable Gross Income: Inclusion of Federally Excluded Foreign Income. The Federal income tax excludes from taxation $15,000 (higher amounts in earlier years) of personal service income of U.S. citizens and residents who are outside the United States for 17 out of 18 months. If the state is a "conforming" state, and if it does not by law eliminate the exclusion, the same income is presumably excluded from state taxable income. If the state is a "nonconforming" state, such income presumably is taxable, unless state law specifically provides the exclusion.

"Yes" signifies that the state treats the income as taxable and does not allow the exclusion. "No" signifies that the state allows the Federal exclusion, or provides its own exclusion, and accordingly does not tax the income. A citizen who has established residence abroad would not be subject to state income tax on personal service income earned abroad unless he also had a tax residence in the state (for example, individuals domiciled in a state that claims all domiciled persons as residents, however long they may be absent from the state).

(8) Deductions: Federal Income Tax. Federal tax law allows state income taxes as a deduction from adjusted gross income. While states do not allow the deduction of other states' income taxes, some states do allow a deduction of the Federal income tax. "Yes" signifies that such a deduction is allowed. "No" signifies that the deduction is not allowed.

(9) Deductions: Foreign Income taxes. The Federal tax law allows a deduction of taxes imposed on net incomes and real property by foreign national and local governments. 1/ Unless "conforming" states specifically eliminate this deduction, they presumably allow it. Unless a "nonconforming" state specifically provides for this deduction, it presumably does not allow it. "Yes" signifies that the deduction of foreign income taxes is allowed for the state income tax. "No" signifies that the deduction is not allowed.

1/ However, if a taxpayer claims a foreign tax credit for any portion of foreign income taxes, he may not claim a deduction for any foreign income tax.

Table A-1

STATE INCOME TAXATION OF RESIDENT INDIVIDUALS
A. Residence Criteria, Gross Income, and Deductions

State	Use of Federal Tax Base	Residence Criteria: Domicile Test	Residence Criteria: Permanent Abode	Residence Criteria: Six Month Test	Taxable Gross Income: Income Source & Types	Taxable Gross Income: Inclusion of Federally Excluded Foreign Income	Deductions: Federal Income Tax	Deductions: Foreign Income Tax
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Alabama	No	Yes	Yes	Yes	All	Yes	Yes	No
Alaska	Yes	Yes	---	1/	Alaska	No	No	Yes
Arizona	No	Yes	---	2/3/	All	Yes	Yes	No
Arkansas	No	Yes	5/	---	All	Yes	No	Yes
California	No	4/	---	2/	All	Yes	No	No
Colorado	Yes	Yes	5/	---	All	No	Yes	Yes
Delaware	Yes	Yes	---	Yes	All	No	No	No
Georgia	Yes	Yes	Yes	Yes	All	No	No	Yes
Hawaii	Yes	Yes	---	7/	8/	No	No	Yes
Idaho	Yes	Yes	---	1/	All	No	No	Yes
Illinois	Yes	4/	---	2/	All	No	No	Yes
Indiana	Yes	Yes	5/	---	All	No	No	Yes
Iowa	Yes	Yes	Yes	---	All	No	Yes	Yes
Kansas	Yes	Yes	---	9/	All	No	Yes	Yes
Kentucky	Yes	Yes	---	Yes	All	No	No	Yes
Louisiana	Yes	Yes	Yes	---	All	No	Yes	Yes
Maine	Yes	11/	5/	---	All	No	No	Yes
Maryland	Yes	Yes 6/	---	Yes	All	Yes	No	No
Massachusetts	Yes	Yes	---	---	All	Yes	No	No
Michigan	Yes	Yes	---	Yes	All	Yes	No	No
Minnesota	Yes	Yes	---	10/	24/	No	Yes	Yes
Mississippi	No	Yes	---	Yes 22/	All	Yes	No	No
Missouri	Yes	11/	5/	---	All	No	No	Yes
Montana	Yes	Yes	Yes 23/	---	All	No	Yes	Yes
Nebraska	Yes	Yes	5/	---	All	No	No	Yes
New Jersey	No	11/	5/	---	All	Yes	No	No
New Mexico	Yes	Yes	---	---	All	No	No	No
New York	Yes	11/	5/	---	All 14/	No	No	Yes
North Carolina	No	Yes	---	9/	All	Yes	No	No
North Dakota	Yes	Yes	12/	---	24/	No	Yes	Yes 15/
Ohio	Yes	Yes	13/	---	All	No	No	No
Oklahoma	Yes	Yes	---	7/	24/	No	No	Yes
Oregon	Yes	11/	7/	---	All	No	16/	21/
Pennsylvania	No	11/	5/	---	17/	Yes	No	No
Rhode Island	Yes	11/	5/	---	All	No	No	No
South Carolina	No	Yes	---	---	18/	Yes	19/	No
Utah	Yes	Yes	5/	---	All	No	No	No
Vermont	Yes	11/	5/	---	All	No	No	Yes
Virginia	Yes	Yes	---	Yes 9/	All	No	No	Yes
West Virginia	Yes	11/	5/	---	All	No	No	Yes
Wisconsin	Yes	Yes	---	---	All	No	No	Yes
Dist. of Columbia	No	6/	---	12/ 20/	All	Yes	No	No

Notes to Table A-1

1/ An individual who is present in the state for the entire taxable year is a resident.

2/ An individual who is present in the state for other than a temporary or transitory purpose is a resident.

3/ An individual who is present in the state for more than nine months of the year is presumed to be a resident, but the presumption can be overcome by evidence that the presence is for a temporary or transitory purpose.

4/ An individual domiciled in the state is not a resident if he is absent from the state for other than a temporary or transitory purpose.

5/ An individual who maintains a permanent place of abode within the state and spends in the aggregate more than six months (or 183 days) in the state during the taxable year is a resident.

6/ An individual who is domiciled in the jurisdiction on the last day of the year is a resident.

7/ An individual who is present in the state for more than 200 days in the taxable year is presumed to be a resident, but the presumption can be overcome by evidence that his presence is temporary or transitory.

8/ For individuals who become residents of Hawaii after the age of 65, only income from Hawaiian sources and from intangible property is taxable by the state.

9/ An individual who is present in the state for more than six months (183 days) of the taxable year is presumed to be a resident, in absence of proof that this presence is only temporary or transitory.

10/ An individual who has an abode in the state for any period of the year is a resident if he has no domicile outside the state.

11/ An individual who is domiciled in the state is a resident unless he has no permanent place of abode in the state, has such a place elsewhere, and is not in the state more than 30 days in the taxable year.

12/ An individual is a resident if he maintains a place of abode in the state and spends in the aggregate more than seven months of the taxable year in the state.

Notes to Table A-1

13/ An individual is a resident if he lives in and maintains a permanent place of abode in the state and does not maintain a permanent place of abode elsewhere, unless he is out of the state for the entire year.

14/ In case of dual residence the taxpayer may be obliged to pay both taxes in full.

15/ Income taxes of foreign countries which are taken by the individual taxpayer as a foreign tax credit for Federal income tax are added to the Federal income tax for purposes of deduction from income for state income tax purposes.

16/ Federal income tax paid is deductible up to $5,000 ($2,500 on separate returns).

17/ Types of income listed as taxable do not include capital gains.

18/ Income that is excludable from Federal income taxation by reason of any treaty is also excluded from income for state tax purposes.

19/ Federal income tax is deductible up to a limit of $500 ($1,000 for married couples.)

20/ Not including an elective officer of the United States or a member of his staff from his home state; also not including executive officers who are appointed by the President with the advice and consent of the Senate unless they were domiciled in the District of Columbia on the last day of the preceding year.

21/ Deduction of the foreign income tax is not allowed if the foreign tax credit is taken on the Oregon return; otherwise the deduction is allowed.

22/ An individual is a resident if he maintains a legal or actual residence in Mississippi; no time requirement is included.

23/ An individual who maintains a permanent place of abode in Montana and has not established a residence elsewhere is a resident even though he is absent from the state.

24/ All labor, personal service and professional income taxed by state; allocation and apportionment applied to other income.

Table A-2

STATE INCOME TAXATION OF RESIDENT INDIVIDUALS:

B. Credits Allowed to Residents for Out-of-State Taxes

This table continues from Table A-1 the description of state income taxes on resident individuals, dealing with the tax credits allowed for out-of-state income taxes. It indicates the taxing jurisdictions whose taxes qualify for the credit and whether the credit is allowed for income taxes imposed by foreign governments. The limitations placed on the credit are also described.

Descriptions of the contents of the various columns are as follows.

(1) State. The income tax states as in Table A-1.

(2) Federal Tax Base. Whether the state "conforms" its adjusted gross income, etc., to the Federal tax, as in Table A-1.

(3) Tax Jurisdiction: State, D. C., Territories, Possessions and Local Governments. The jurisdictions, other than foreign, whose income taxes qualify for the state's tax credit are indicated by the following code letters:

S/ = the other 49 states of the United States.

D/ = the District of Columbia.

T/ = Territories of the United States.

P/ = Possessions of the United States and Puerto Rico.

L/ = local governments of the qualifying states.

No = no credit is allowed. (The only state allowing no credit is Alaska, which taxes only income from Alaskan sources.)

(4) Tax Jurisdiction: Foreign Governments. This column indicates whether the state allows a credit for foreign income taxes similar to that allowed for income taxes of other states. "Yes" signifies that such a credit is allowed. "No" signifies that no credit is allowed. Footnotes indicate special situations.

(5) Income Qualified for Tax Credit: Geographic Sources. "All" signifies that language of the state law providing the credit does not

place any limits on the geographic source of the income on which the other state or foreign government taxes this state's resident. "Out-of-state" signifies that only taxes on income from sources outside the state qualify for the credit. "Other state" signifies that the only taxes qualifying for the credit are those imposed on income that has its source within the state or other jurisdiction imposing the tax.

(6) Income Qualified for Tax Credit: Income Types. "All" signifies that no limit is placed on the type of income subject to the tax for which credit is allowed. The footnotes indicate various limits that are set by certain states.

(7) Reciprocity Requirements. "Pos.", an abbreviation for "positive", signifies that the state does not allow its residents the credit unless the state whose tax is being claimed for credit allows a similar credit to its own residents with respect to taxes imposed by this state. "Neg.", an abbreviation for "negative", signifies that the state does not allow the credit if the other state (or other jurisdiction) grants a credit to this taxpayer for taxes imposed on him by this state. The purpose of a negative limit is to prevent the taxpayer from claiming a double credit, thus paying less in total tax than would a taxpayer who derived all his income from sources within the state. A dash signifies that the state allows its residents the credit whether or not the state whose tax is being credited allows a similar credit to its own residents or to this taxpayer with respect to taxes imposed by this state.

(8) Limits to Amount of Credit. Most states set limits on the amount of credit that can be taken for taxes imposed by other jurisdictions. In all states the credit is limited to the tax imposed by the state granting the credit. Further limits usually involve one of two computations.

"Prop.", an abbreviation for "proportional", signifies that the tax credit is limited to the same proportion of the tax imposed by this state as the income taxed by the other state is of total income.

"Added T.", an abbreviation for "added tax", signifies that the limit on the tax credit is the amount added to the resident's tax as a result of including the income also taxed by the other state. If this state's tax is imposed at progressive rates, the "added tax" limit may be greater in amount than the "proportional" limit. Some states include both limits, presumably to ensure that the smaller limit applies, while other states, indicated by a dash, " - ", specify no special limit on the amount of the credit. The footnotes indicate combinations of limits or special situations.

Table A-2

State Income Taxation of Resident Individuals:
B. Credits Allowed to Residents for Out-of-State Taxes

State	Federal Tax Base	Tax Jurisdiction		Income Qualified for Tax Credit		Reciprocity Requirements	Limits to Amount of Credit
		State, DC, Ter. Poss. Local Gov't.	Foreign Gov't.	Geographical Sources	Income Types		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Alabama	No	S/T	No	Out-of-S	11/	---	---
Alaska	Yes	No	No	---	---	---	---
Arizona	No	S/D	Yes	1/	All	Neg.	Prop.
Arkansas	No	S/T	No	Other St	11/	---	Added T.
California	No	S/D/P	No	1/	All	Neg.	Prop.
Colorado	Yes	S/D/T/P	No	Other St	All	---	Prop.
Delaware	Yes	S/D/T/P	No	All	All	---	Prop.
Georgia	Yes	S/	No	Other St	All	---	Added T.
Hawaii	Yes	S/D/T/P	Yes	1/	All	---	Added T.
Idaho	Yes	S/T	No	All	All	Neg.	Prop.
Illinois	Yes	S/D/T/P	Yes 13/	All	All	---	Prop.
Indiana	Yes	S/D/T/P	No	All	All	---	---
Iowa	Yes	S/	Yes	Other St	All	---	Added T.
Kansas	Yes	S/	No	Other St	All	---	Prop.
Kentucky	Yes	S/	No	Out-of-S	All	---	Added T.
Louisiana	Yes	S/	No	1/	All	---	---
Maine	Yes	S/D/L	No	Other St	All	---	Prop. 4/
Maryland	Yes	S/	No	All	All	---	---
Massachusetts	Yes	S/T/P	5/14/	All	All	---	Prop.
Michigan	Yes	S/D/L	No 6/	Out-of-S	All	---	Prop.
Minnesota	Yes	S/T/P	No	All	12/	Neg.	Prop.
Mississippi	No	S/T/P	No	All	All	---	7/
Missouri	Yes	S/D/L	No	All	All	---	Prop.
Montana	Yes	S/	Yes 15/	1/	All	Neg.	---
Nebraska	Yes	S/D/L	No	Other St	All	---	Prop. 4/
New Jersey	No	S/D/L	No	All	All	---	---
New Mexico	Yes	S/D	No 6/	Out-of-S	All	---	17/
New York	Yes	S/D/L	No	All	All	---	Prop. 8/
North Carolina	Yes	S/	Yes	1/	All	---	Prop. 4/
North Dakota	Yes	S/T/D	No	All	9/	---	Added T.
Ohio	Yes	S/D	No	All	All	---	Prop.
Oklahoma	Yes	S/	No	Other St	12/	---	---
Cregon	Yes	S/D	Yes	Other St	All	---	Prop.
Pennsylvania	No	S/T/P	Yes	All	All 3/	---	Prop.
Rhode Island	Yes	S/D	No	1/	All	---	Prop. 4/
South Carolina	No	S/	No	Other St	12/	---	Prop.
Utah	Yes	S/D/P	No	All	All	---	Added T.
Vermont	Yes	S/D/T	No	Other St	All	---	---
Virginia	Yes	S/D/T/P	No	All	All	Pos.	Prop.
West Virginia	Yes	S/D	No	All	All	Neg.	Prop. 8/
Wisconsin	Yes	S/D	No	All	12/10/	---	Prop.
Dist.of Col.	No	S/T/L 2/	No	All	16/	---	---

Notes to Table A-2

1/ Credit is allowed only if income is taxed by other states "irrespective of residence".

2/ Credit is allowed only for taxes imposed by jurisdiction of domicile.

3/ Credit is limited to tax on types of income subject to income tax of this state.

4/ Provision is made for reciprocal tax reduction in case of dual residence.

5/ State credit is reduced by any Federal credit allowable for such tax.

6/ Credit is not allowed, due to rulings of Attorney General or courts, despite statutory inclusion of "territory", "possession", and "foreign country" in definition of "state".

7/ Credit is limited to tax computed at highest applicable Mississippi rate.

8/ Credit is further limited to not more than additional state tax resulting from inclusion of income on which credit is computed.

9/ Credit is allowed for tax on income from personal services or intangibles "assigned to state".

10/ After 1976, tax on income of all types is eligible for credit in Wisconsin.

11/ Credit is allowed for tax on income from out-of-state business or property.

12/ Credit is allowed for tax on personal service income only.

13/ Illinois also allows credit for income taxes imposed by political subdivisions of foreign countries.

14/ Credit is allowed by Massachusetts only for income taxes imposed by Canada and Canadian provinces.

15/ Taxpayer cannot take both a deduction and a credit for foreign taxes.

16/ Credit is allowed for taxes on income and taxes on intangible personal property.

17/ New Mexico allows a credit not to exceed 5 1/2 percent of net income.

Table A-3

STATE INCOME TAXATION OF NONRESIDENT INDIVIDUALS

This table describes aspects of the state taxation of nonresident individuals that may be significant for interstate, Federal-state, and international tax relations.

(1) State. State imposes general income taxes, as in Table A-1.

(2) Federal Tax Base. Whether the state "conforms" its adjusted gross income to the Federal tax or not, as in Table A-1.

(3) Source of Taxed Income: State Only. "Yes" signifies that nonresidents are taxed only on income from sources defined by the state as being within the state. Footnotes indicate special provisions. The fact that all states are "Yes" is the result of limitations imposed by judicial interpretation of the U.S. Constitution or by Federal law.

(4) Federal Income Tax Deductible. "Yes" signifies that the state allows as a deduction that part of the Federal income tax paid by the taxpayer which corresponds to the fraction of the nonresident's total income subject to taxation by the state. "No" signifies that the nonresident is not allowed any deduction for Federal income tax paid.

(5) Credit for Out-of-State Taxes: Jurisdictions Qualifying. "No" signifies that nonresidents are specifically denied credit for taxes imposed by other jurisdictions. "Home State" signifies that a credit is allowed only for taxes imposed by the state of residence of the taxpayer. "S/" and "F/" signify that, in at least some situations, a credit is allowed to nonresidents for taxes imposed by other states or foreign governments, respectively. A dash " - " signifies that no reference was found in the statute to a credit for nonresidents and that presumably none is granted.

(6) Credit for Out-of-State Taxes: Types of Income. A dash " - " signifies that no credit is allowed. The names of the states, together with the footnotes, describe the sources and types of income that qualify in those cases in which a credit is allowed.

(7) Reciprocity and Other Limits. A dash " - " signifies either that no credit is allowed (see column (5)) or that no limits are specified in the statute. "Pos.", an abbreviation for "positive", signifies that for the credit to be allowed the other state must grant a similar credit (or an exemption) to residents of this state. "Neg.",

an abbreviation for "negative", signifies that if the other state grants this taxpayer a credit for taxes imposed by this state, and that credit is contingent on this state itself not granting a credit, no credit is allowed. The purpose of this provision is to ensure that the taxpayer receives one, and only one, credit. If the other state grants an unconditional credit, this state will not grant a credit.

Table A-3

STATE INCOME TAXATION OF NONRESIDENT INDIVIDUALS

State	Federal Tax Base	Source of Taxed Income: State Only	Federal Income Tax Deductible	Credit for Out-of-State Taxes		
				Jurisdictions Qualifying	Types of Income	Reciprocity and and Other Limits
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Alabama	No	Yes 11/	Yes 9/	No	---	---
Alaska	Yes	Yes	No	---	---	---
Arizona	No	Yes	Yes 9/	S/F	Arizona	Pos/Neg
Arkansas	No	Yes	No	---	---	---
California	No	Yes	No	Home State	Californ	Pos/Neg.4/
Colorado	Yes	Yes	No	No	---	---
Delaware	Yes	Yes	No	---	---	---
Georgia	Yes	Yes 6/	No	---	---	---
Hawaii	Yes	Yes	No	---	---	---
Idaho	Yes	Yes	No	Home State	Idaho	Pos/Neg
Illinois	Yes	Yes	No	---	---	---
Indiana	Yes	Yes	No	S/	Indiana	Pos
Iowa	Yes	Yes	Yes 9/	---	---	---
Kansas	Yes	Yes	Yes 9/	---	---	---
Kentucky	Yes	Yes 7/	Yes 9/	No	---	---
Louisiana	Yes	Yes	Yes 9/	---	---	---
Maine	Yes	Yes	No	---	---	---
Maryland	Yes	Yes	No	Home State	Maryland	Pos 1/4/
Massachusetts	Yes	Yes	No	No	---	---
Michigan	Yes	Yes	No	Home State	Michigan	Pos 3/2/
Minnesota	Yes	Yes	No	S/	10/	Pos
Mississippi	No	Yes	No	---	---	---
Missouri	Yes	Yes 5/	No	---	---	---
Montana	Yes	Yes	Yes	No	---	---
Nebraska	Yes	Yes	No	---	---	---
New Jersey	No	Yes	No	---	---	---
New Mexico	Yes	Yes	No	Home State	No Limit	Pos 4/
New York	Yes	Yes	No	No	---	---
North Carolina	No	Yes	No	---	---	---
North Dakota	Yes	Yes	Yes	No	---	---
Ohio	Yes	Yes	No	S/	---	Prop.
Oklahoma	Yes	Yes	No	---	---	---
Oregon	Yes	Yes	Yes 9/	---	---	---
Pennsylvania	No	Yes	No	---	---	---
Rhode Island	Yes	Yes	No	---	---	---
South Carolina	No	Yes 8/	Yes 9/	---	---	---
Utah	Yes	Yes	Yes 9/	No	---	---
Vermont	Yes	Yes	No	No	---	---
Virginia	Yes	Yes	No	Home State	Virginia	Pos 4/ 5/
West Virginia	Yes	Yes	No	Home State	No Limit	Pos 4/ 5/
Wisconsin	Yes	Yes	No	---	---	---
Dist.of Col.	No	12/	No	---	---	---

Notes to Table A-3

1/ Credit is not applicable against local income taxes in Maryland.

2/ Credit is allowed also for income taxes by local jurisdictions.

3/ The reciprocal exemption of personal service income is authorized if a bilateral agreement is entered into with the home state of the taxpayer.

4/ Credit is allowed only if the other state provides a reciprocal credit or exemption for residents of this state. Maryland limits the reciprocal exemption to personal service income.

5/ Tax is first computed as if the taxpayer were a resident, and is then multiplied by the fraction that income from state sources bears to total income. The result is a proportional limitation on the credit.

6/ Nonresident individuals with very little Georgia income from personal services may not be taxable in Georgia.

7/ Agreements are in effect with a few states reciprocally exempting salaries and wages of their residents.

8/ Income that is excludable from Federal income taxation by reason of any treaty is also excluded from income for state tax purposes.

9/ Nonresident individuals are allowed to deduct the portion of their Federal income tax that is attributable to income from state sources. Oregon limits the deduction to $5,000, South Carolina presumably to a proportionate share of the $500 allowed to residents.

10/ Credit is allowed for tax on personal service income only.

11/ Income from intangible personal property which has a "situs" in Alabama is taxable to nonresidents. No definition or explanation of "situs" was found.

12/ Nonresidents are subject to District of Columbia income tax only on income from unincorporated businesses carried on in the District.

Table A-4

ALLOCATION AND APPORTIONMENT
OF INCOME AMONG JURISDICTIONS

This table describes the rules adopted by states for determining to which state income is assigned for tax purposes, and for apportioning among jurisdictions that income (chiefly business income) which is generated by activities carried on in two or more states.

Descriptions of the contents of the various columns are as follows.

(1) State. All states imposing general net income taxes on individuals, as in Table A-1.

(2) Federal Tax Base. Whether the state "conforms" its adjusted gross income to Federal law or not, as in Table A-1.

(3) Residents: All Income to State/Tax Credit A & A. This column plays a dual role. A "Yes" placed to the left of the "/" signifies that the state taxes the entire net income of its resident individual taxpayers, regardless of geographical source of the income. A "Yes" placed to the right of the "/" signifies that the state law specifies rules for the allocation and apportionment of the income that qualifies for the tax credit allowed for taxes imposed by other states. A dash " - " placed to the right of the "/" signifies that the wording of the tax credit provision is such that no allocation and apportionment (A & A) is needed with respect to the tax credit allowed residents. A question mark "?" placed to the right of the slash "/" signifies that although some rule for allocation and apportionment would seem to be needed with respect to the income qualifying for the tax credit, the state law appears to be silent. (In such a case, presumably allocation and apportionment methods used in the case of nonresidents would be applied in reverse.) A footnote in the column signifies a special situation.

(4) Nonresident individuals: Nonbusiness Income: Special Allocation. This column deals with the allocation of income other than business income, namely, salaries, wages, rents, royalties, interest, dividends, capital gains, and so forth, that are not connected with a business operation. "Yes" signifies that the state law sets out rules allocating items of nonbusiness income among jurisdictions.

(5) Nonresident Individuals: Business Income: 3-Factor Formula. When a business is carried on in two or more jurisdictions it

is necessary to divide the income among the jurisdictions for the purposes of avoiding multiple taxation of the same income and of assuring that business income of multistate (or multinational) business has the same chance of being fully taxed as the income of business carried on within a single jurisdiction. In this column "Yes" signifies that in the allocation and apportionment of multistate (or multinational) business income, the state prefers an apportionment formula giving equal weight to property, payroll, and sales. The footnotes indicate deviations of states from this 3-factor formula apportionment.

(6) Nonresident Individuals: Business Income: Separate Accounting/Other. This column plays a dual role in indicating to what extent the state recognizes separate accounting and other methods of allocating and apportioning income other than by formula. A "Yes" placed to the right of the slash "/" indicates that separate accounting is specifically mentioned as a method which may be used (or in some cases must be used) under certain circumstances. A dash " - " placed to the right of the slash "/" signifies that no mention was made of other methods. Footnotes describe the situation in various states. A dash "-" with no slash "/" signifies that neither separate accounting nor other methods (aside from formula apportionment) are specified in tax law.

Most if not all the states, either through specific authorization or in the grant of general powers, give the tax administrator authority (either at his own initiative or upon application of the taxpayer) to prescribe or permit deviations from the methods specified in the law, if such deviations would give a more equitable division of income. No attempt was made to identify these powers.

(7) Multistate Tax Compact Alternative. Those states that have adopted the provisions of the Multistate Tax Compact relating to the allocation and apportionment of income are obliged to give their taxpayers the alternative of employing the rules of the Compact instead of rules otherwise prescribed in the state tax law. The MTC prescribes rules for specific allocation and the 3-factor apportionment formula. The Multistate Tax Compact allocation and apportionment option is available only to taxpayers having income subject to allocation and apportionment, thus excluding from the option residents of states that tax their entire income without apportionment.

Table A-4

ALLOCATION AND APPORTIONMENT OF INCOME AMONG JURISDICTIONS

State	Federal Tax Base	Residents All Income to State/Tax Credit A&A	Nonresident Individuals: Nonbusiness Income Specific Allocation	Nonresident Individuals: Business Income: Unitary 3-factor Formula	Nonresident Individuals: Business Income: Separate Accounting/Other	Multistate Tax Compact Alternative
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Alabama	No	Yes/?	Yes	Yes	---	No
Alaska	Yes	1/	Yes	Yes	---	Yes
Arizona	No	Yes/?	Yes	Yes	---	No
Arkansas	No	Yes/-	Yes	Yes	Yes/-	Yes
California	No	Yes/?	Yes	Yes	Yes/2/	No
Colorado	Yes	Yes/?	Yes	3/	Yes/-	Yes
Delaware	Yes	Yes/-	Yes	4/	4/	No
Georgia	Yes	Yes/-	Yes	Yes 12/5/	Yes/5/	No
Hawaii	Yes	Yes/-	Yes	Yes 6/	Yes/-	Yes
Idaho	Yes	Yes/-	Yes	Yes	Yes/8/	Yes
Illinois	Yes	Yes/-	Yes	Yes	---	No 7/
Indiana	Yes	Yes/-	Yes	Yes	8/	Yes
Iowa	Yes	Yes/?	Yes	No 10/9/	Yes/-	No
Kansas	Yes	Yes/?	Yes	Yes	8/	Yes
Kentucky	Yes	Yes/?	Yes	Yes	8/	No
Louisiana	Yes	Yes/-	Yes	Yes 11/	8/	No
Maine	Yes	Yes/?	Yes	Yes	---	No
Maryland	Yes	Yes/-	Yes	13/	Yes/-	No
Massachusetts	Yes	Yes/?	Yes	Yes	8/	No
Michigan	Yes	Yes/?	Yes	Yes	---	Yes
Minnesota	Yes	22/	Yes	Yes	Yes8/	No
Mississippi	No	Yes/-	Yes	14/	Yes/-	No
Missouri	Yes	Yes/-	Yes	Yes	8/	Yes
Montana	Yes	Yes/?	Yes	Yes	Yes/-	Yes
Nebraska	Yes	Yes/?	Yes	Yes	---	No
New Jersey	No	Yes/-	4/	4/	4/	No
New Mexico	Yes	Yes/?	Yes	Yes	Yes/5/	Yes
New York	Yes	Yes/Yes	Yes	16/	16/	No
North Carolina	No	Yes/?	5/	5/	5/	No
North Dakota	Yes	18/	Yes	Yes	8/	Yes
Ohio	Yes	Yes/?	Yes	Yes	---	No
Oklahoma	Yes	18/	Yes	Yes	---	No
Oregon	Yes	Yes/?	Yes	Yes	---	Yes
Pennsylvania	No	Yes/-	19/	Yes	---	No
Rhode Island	Yes	Yes/Yes	Yes	4/	---	No
South Carolina	No	Yes/-	Yes	Yes	---	No
Utah	Yes	Yes/?	Yes	Yes	---	Yes
Vermont	Yes	Yes/?	Yes	20/	20/	No
Virginia	Yes	Yes/?	Yes	Yes	Yes/-	No
West Virginia	Yes	Yes/-	Yes	21/	21/	No
Wisconsin	Yes	Yes/-	Yes	Yes15/	Yes/-	No
Dist. of Col.	No	Yes/-	17/	17/	17/	No

Notes to Table A-4

1/ Income of residents appears to be allocated and apportioned in the same manner as that of nonresidents.

2/ Only if the income from inside the state is separate and distinct from the income from outside the state; otherwise the 3-factor formula must be used.

3/ Business income is apportioned one-half on the basis of real and tangible personal property, one-half on the basis of gross receipts, but the taxpayer is entitled to use Multistate Tax Compact option.

4/ Determined by administrative rules and regulations.

5/ Under rules and regulations of the administrator.

6/ Various formulae: property and payroll for producing and manufacturing, etc.; otherwise the 3-factor formula; the Multistate Compact option is also available.

7/ MTC adopted in 1967, repealed in 1975.

8/ Separate accounting on petition of the taxpayer or determination of the administrator.

9/ Apportionment on basis of sales or gross receipts.

10/ No statutory provision for apportionment of income from interstate activities for nonresident individuals.

11/ The 3-factor formula is used for manufacturing and merchandising; various methods for other industries.

12/ A 2-factor formula using property and sales is used (the 3-factor formula is available for corporations but appears not to be available for nonresident individuals).

13/ The 3-factor formula is used only when separate accounting is not feasible; special formulae for some industries.

14/ There are no statutory rules; each case is dealt with individually.

15/ A special 3-factor formula is used: property 1/2, sales 1/4, payroll 1/4.

16/ Administrative rules and regulations permit separate accounting; commissioner may apply 3-factor apportionment.

Notes to Table A-4

17/ Nonresidents are not subject to the District of Columbia income tax except to the extent that they conduct an unincorporated business within the District. Income of such businesses (as well as of corporations) is apportioned by a 3-factor formula, but income from intangible property of a taxpayer with a District "commercial domicile" is allocated to the District.

18/ Personal service income is allocated to the state; other income is apparently allocated and apportioned as in the case of nonresident taxpayers.

19/ Under regulations to be issued to allocate income, the source of which cannot be readily or accurately determined.

20/ No statutory provision; commissioner has authority to issue regulations.

21/ Taxpayer can employ any fair and equitable method, but commissioner may prescribe the method.

22/ Personal service and professional income of residents is allocated to state; nonbusiness income is subject to specific allocation; business income is apportioned using a special 3-factor formula: sales 70 percent, property 15 percent, payrolls 15 percent.

STATE TAXATION OF CORPORATE INCOME FROM FOREIGN SOURCES

George Carlson

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I. ISSUES AND SCOPE

This paper addresses the issue of whether the states tax corporate income from sources outside the United States, as defined by Federal law, and, if so, whether this taxation should be limited by the Federal government. Only a few states have special rules with respect to the taxation of foreign (outside the United States) source income. In most cases, the treatment of foreign source income derives from general rules for taxing a multistate (or multinational) corporation. After explaining the Constitutional restrictions on the states' power to tax, this paper describes the general rules with respect to such items as jurisdictional nexus, definition of taxable income, and the division of taxable income. The extent to which foreign source income is taxed at the state level, under these rules, is explained and analyzed in terms of double taxation, reduction of the Federal tax base, and administrative complexity. A major point of the paper is that, to the extent problems exist, they are not in most instances unique to foreign source income, but apply equally to domestic source income. Still, for reasons of international harmony, foreign source income may require special treatment and the paper concludes with a discussion of possible options.

II. PRESENT LAW

1. Constitutional issue. Apart from providing a deduction for foreign taxes deemed paid on dividends from foreign corporations, only a few states provide special rules with respect to the taxation of foreign source corporate income. Thus, in most instances, the tax treatment of foreign source corporate income depends on a state's general rules for taxing the activities of a multistate corporation. Within the parameters of the Commerce and Due Process Clauses of the United States Constitution (Art. I. Sec. 8, Clause 3; 14th Amendment, Sec. 1) the states are accorded substantial latitude in establishing rules and regulations for the taxation of multistate corporations.

The courts have taken the position that a state may tax the activities of a multistate corporation provided there is a jurisdictional nexus in the state and provided the taxation does not unreasonably or unduly burden interstate commerce.

In the case of a corporation legally domiciled within a state (chartered by that state), the state has a personam jurisdiction and may tax all the corporation's net income, with minor exceptions, whether or not derived from sources within the state. Lawrence et. al. v. State Tax Commission, 286 U. S. 276 (1932). However, in the case of a foreign corporation, one legally domiciled in another state or country, the state has only an in rem jurisdiction and may tax only the income earned within the state. Hans Rees' Sons, Inc. v. State ex. rel. Maxwell, 283 U. S. 123 (1931).

The states have developed, and the courts have sanctioned, a variety of methods for determining what portion of a corporation's taxable income was earned within a particular state. In fact, much of the debate over whether states do or do not tax foreign source income centers on the operational effect of these income division methods as applied to corporations with an out-of-state domicile. Nearly all states also give locally domiciled corporations the privilege of using these income division methods so as to avoid placing them in an adverse position relative to competitors legally domiciled in other states.

Forty-six states1/ levy corporate income taxes; 2/ these are either direct taxes on income or indirect excise or franchise taxes measured by income. The courts have held that a state may not

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1/ Including the District of Columbia.

2/ Michigan's recently enacted single business tax could be characterized as a value added type levy. However, corporate net income is in the tax base.

levy an indirect excise tax on the privilege of carrying on a business within a state if the taxpayer is engaged solely in interstate commerce. Spector Motor Service v. O'Connor, 340 U. S. 602 (1951). Noting the exclusively interstate character of the taxpayer's Connecticut business activities, the Court concluded that although the measure of the tax (income) was reasonable, the state had exceeded its authority because it had selected a subject for taxation which it had no authority to tax, namely the privilege of engaging in interstate commerce. The Court found its:

> [C]onclusion not in conflict with the principle that, where a taxpayer is engaged both in intrastate and interstate commerce, a state may tax the privilege of carrying on intrastate business and, within reasonable limits, may compute the amount of the charge by applying the tax rate to a fair proportion of the taxpayer's business done within the state, including both interstate and intrastate. 1/

In 1959 the United States Supreme Court affirmatively answered the question of whether a state could impose a direct income tax upon the income of a foreign (out-of-state) corporation derived solely and exclusively from interstate commerce. Northwestern States Portland Cement Co. v. Minnesota, 358 U. S. 450 (1959). Relying primarily on its earlier per curiam affirmance of the application of the California income tax in West Publishing Co. v. McColgan, 328 U. S. 823 (1946), the Court distinguished between a tax whose subject is the privilege of engaging in interstate commerce and a tax whose subject is the net income from such commerce. Quoting from the California decision in West Publishing Company, the Supreme Court held:

> It is settled by decisions of the United States Supreme Court that a tax on net income from interstate commerce does not conflict with the commerce clause. 27 Cal. 2d 705, 708-709, 166 P.2d 861, 863. 2/

The Court concluded:

> Net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus to support the same. 3/

1/ 340 U. S. at 609-610.

2/ 358 U. S. at 461.

3/ 358 U. S. at 452.

Thus, within the confines of the Commerce and Due Process Clauses of the Constitution, a state may:

A. Tax all the income of a domestic (in-state) corporation; and

B. Tax that portion of the income of a foreign (out-of-state) corporation generated within its borders provided:

(1) There is sufficient nexus between the taxpayer and the state; and

(2) It is a direct tax on income; or if it is an excise tax on the privilege of doing business, the corporation is not engaged solely in interstate commerce.

Applied to income earned from sources outside the United States, this reasoning suggests:

A. That a state may tax the foreign source income of a domestic (in-state) corporation;

B. That a state may not tax the foreign source income of a foreign (out-of-state) corporation; and

C. That the Federal Government has ample authority, under the Commerce and Due Process Clauses, to prohibit states from taxing the foreign source income of foreign (out-of-state) corporations.

2. State taxation of interstate commerce. Forty-six states levy corporate income taxes, either direct taxes on net income or indirect excise or franchise taxes on the privilege of doing business measured by net income, or both. Legal considerations strongly influence the choice. A state may levy a direct income tax, but not an excise or franchise tax, on an out-of-state corporation engaged solely in interstate commerce. Alternatively, a state may include interest on Federal obligations in the tax base of an excise tax, measured by net income, but not in the base of a direct tax on net income. Thus, a frequent pattern is for states to levy both a direct income tax and an excise tax measured by net income with a provision for the taxpayer to pay the tax under the higher of the two levies. This pattern can be seen from Table 1. Forty-six states levy some type of tax on corporate net income; 37 states levy a direct net income tax; 33 states levy an excise tax measured by net income; and 24 states levy both taxes. In practice, the income tax usually applies to nonfinancial corporations and the excise tax to financial institutions, since financial institutions have significant holdings of Federal Government obligations, the interest on which can be included in the excise tax base but not in the income tax base.

(a) Jurisdictional nexus. The state of legal domicile has an indisputable right to tax its own corporations. States may also tax foreign (out-of-state) corporations with a jurisdictional nexus in the state. The rules of jurisdictional nexus are summarized in Table 1. They are exceedingly broad and offer little guidance as to whether a particular activity will make an out-of-state corporation liable to tax. Frequent statutory criteria are: "doing business in a state"; "carrying on business within the state"; and "owning property within state". Finally, in six states the statute does not specify any jurisdictional tests.

While every state would consider the maintenance of a factory or of a retail store sufficient to create a jurisdictional nexus, it is less clear what types of storage or other sales activity would subject a corporation to tax liability. The Willis Committee contacted the state tax administrators for answers that would shed light on this question. 1/ The administrators were presented with a hypothetical situation in which a corporation had a place of business outside the state in question, but was carrying on certain activities in that state. While the answers were not uniform, the following activities were generally considered sufficient to create a tax nexus: sales obtained through telephone or mail orders (without salesmen in the state) plus a stock of raw materials in the state or an administrative office in the state; sales obtained through independent contractors with offices accepting orders in the state and handling goods in the state consigned to customers; a stock of goods in the state from which goods are delivered in the state by common carrier; a sales office in the state; and installation or assembly of a corporation's products in the state by its salesmen. 2/

Conversely, the following activities generally were considered insufficient to create a tax nexus: sales obtained through telephone or mail orders (without salesmen in the state) and sales catalogs mailed to prospective customers in the state; sales obtained through independent contractors with offices accepting orders in the state on the corporation's behalf and no other activities; salesmen regularly

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1/ State Taxation of Interstate Commerce, Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee of the Judiciary, House of Representatives, 88th Cong., 2nd Sess., H. R. No. 1480, 1964. See Volume 1, Chapter 6. This study is popularly referred to as the Willis Report, after Congressman Edwin E. Willis of Louisiana, then Chairman of the Subcommittee.

2/ State Taxation of Interstate Commerce, Volume 1, pp. 148-149.

soliciting orders in the state, but without authority to accept them; telephone answering service in the state with a local directory listing; and salesmen residing in the state using homes for maintaining records only. 1/

The Supreme Court examined the nexus issue in its 1959 decision in Northwestern States Portland Cement Company v. Minnesota, 358 U. S. at 465. An Iowa corporation was operating a cement manufacturing plant in Mason City, Iowa and engaged in the regular solicitation of orders in Minnesota. Although the corporation maintained a sales office in Minnesota, all orders were approved and filled from the corporation's Iowa headquarters. The Court upheld the right of Minnesota to levy an income tax on the corporation's activities since the sales offices located in Minnesota constituted sufficient nexus. The Court observed that the "state has exerted its (taxing) power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred." 2/ In effect, the Court said that a State could tax a corporation when it provided benefits and markets to that corporation.

Because of the Northwestern decision and the refusal of the Supreme Court to review a state court's decision upholding the imposition of an income tax where the activities of the out-of-state corporation were limited to the solicitation of orders, 3/ the business community became concerned that states would seek to expand the jurisdiction of their income taxes. Congress responded by passing Public Law 86-272 in 1959 (15 U. S. C. 381). This law is significant for three reasons.

First, it established a minimum jurisdictional standard, prohibiting a state from levying an income tax when a business's activities within a state are confined to soliciting orders or using an independent contractor to make sales within the state.

Second, it mandated a full study of the problems associated with state taxation of interstate commerce, for the purpose of making legislative recommendations. The four volume study was published in 1964 as the Willis Report.

Third, it marked the first time that Congress had exercised its power under the Commerce Clause to regulate the taxation of multistate business.

1/ State Taxation of Interstate Commerce, Volume 1, pp. 148-149.

2/ 358 U. S. at 465.

3/ International Shoe Co. v. Fontenot, 107 So. 2d. 640 (1958); cert. denied, 359 U. S. 984(1959).

However, there remains a vast gray area lying between the operation of a factory or of a retail store on the one hand and the soliciting or independent contractor activities made nontaxable by Public Law 86-272 on the other, in which a corporation may find itself taxable or not, depending on its activities and the particular state statute.

(b) Definition of taxable income. Once a corporation is found to have sufficient nexus to be taxable in a particular state, the question of defining taxable income becomes important. The 46 states which levy corporate income taxes can be grouped into two categories: those using a definition of taxable income similar to that specified for Federal purposes by the Internal Revenue Code and those using a definition of taxable income that is independent of the Federal definition. According to Table 1, there are 34 states in the former category and 12 states in the latter category.

The 34 "conforming" states which follow the Federal base generally define taxable income as a modified version of that reported for Federal income tax purposes. Taxable income for state purposes is the income reported on line 28 or 30 of the Federal corporate income tax return (Form 1120 or a variant form), respectively, before or after the net operating loss deduction and special deductions, but frequently modified by differential treatment for such items as capital gains, losses, depreciation allowances, and dividends. Each of the 12 "nonconforming" states constructs its own concept of net income, starting from a definition of gross income and subtracting those deductions which are specified by statute. The "nonconforming" states do not entirely disregard the concept of net income as defined in Federal tax law.

(c) Division of taxable income among states. Once it is established that a corporation's activities are sufficient for it to be taxable in a particular state and once taxable income has been defined, it becomes necessary for the state to determine what portion of a corporation's total taxable income is attributable to sources within that state. The states use one or more of the following three methods in making this determination: (i) separate accounting; (ii) specific allocation; (iii) formula apportionment.

(i) Separate accounting. The separate accounting method attempts to treat the in-state sales and expenses of a multistate corporation as if they were carried on by a separate and distinct economic unit. This method can be applied fairly easily to a corporation which operates retail stores in several states and has no manufacturing or production activity. Most situations, however, are not that simple. For example, it is rather difficult to apply the separate accounting method to the multistate activities of an integrated steel corporation that performs mining, production, distribution, and sales operations in several states. Pricing of intra-company transactions and the allocation of general overhead expenses are just two of the more obvious problems. This is probably why separate accounting, once the preferred method for dividing the tax base, has become relatively unimportant. 1/

(ii) Specific allocation. Under the specific allocation method, certain items of income are attributed in their entirety either within or without a state's tax base. This approach attempts to identify particular items of income with their geographic source. Some state statutes identify certain types of income, such as capital gains, dividends, interest , rents, and royalties that are to be specifically allocated. Other statutes follow a business-nonbusiness income classification. 2/ Each state's allocation practice is described in detail in Table 2 and is only summarized here.

Many states use a double filter: income is specifically allocated only if it is nonbusiness income, and only if it is of a type identified in the statute. Nonbusiness income is usually the residual, encompassing all income that is not business income.

States differ in how they define business income. Some, such as Arkansas, Colorado, and Rhode Island presumptively consider nearly all income to be business income. In these states, little, if any, income is subject to specific allocation. Other states, such as Indiana, Kentucky, and North Carolina define business income less broadly. States in this group tend to use a definition of business income similar to that in the Uniform Division of Income for Tax Purposes Act. According to the UDITPA, business income is:

> [I]ncome arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. 3/

1/ Many states, however, allow or require separate accounting where necessary to correct an inequitable or unfair allocation or apportionment based on statutory formulas.

2/ This distinction is contained in the Uniform Division of Income for Tax Purposes Act (UDITPA), proposed by the National Conference of Commissioners on Uniform State Laws in 1957. The Act suggests rules to achieve more uniform taxation of the activities of a multistate business. Many states follow the Act to some degree, but few follow it verbatim. For a more detailed discussion of the Act and other steps toward uniformity, see the essay by Roy Blough, in this volume, "State Taxation of Individual Income from Foreign Sources".

3/ Uniform Division of Income for Tax Purposes Act, Section 1(a).

Under this type of definition, in addition to branch income, the following items of income would generally be considered as business income not subject to specific allocation: interest earned on accounts receivable or certificates of deposit; capital gains on trade or business property; rental income resulting from a principal business activity of the taxpayer or if the rental of the property is related to or incidental to the taxpayer's principal business activity; and royalties from a license or patent used to produce a product similar to that produced by the taxpayer.

Under UDITPA, the definition of business income does not necessarily include all the income of a business enterprise and some items of income may be classified as nonbusiness income subject to specific allocation. If so, as indicated by Table 2, they would tend to be allocated in the following way: dividends and interest to the recipient's commercial domicile 1/; capital gains, rents, and royalties on real property to the situs of the asset; capital gains on tangible personal property to the situs of the property or the taxpayer's commercial domicile if not taxable in the situs state; capital gains on intangibles to the recipient's commercial domicile; and rents and royalties on tangible and intangible personal property on the basis of the extent of use in the state or, if not taxed where used, to the recipient's commercial domicile.

The treatment of dividends deserves special mention because of their importance with respect to the taxation of foreign source income. Six states--Kentucky, Maryland, Michigan, Missouri, Pennsylvania, and West Virginia--exempt all intercorporate dividends, whether from foreign or domestic sources. The remaining 40 states follow a variety of approaches, including partial exemption of subsidiary dividends (along the lines of the Federal dividend received deduction), specific allocation of some dividends to the payee's commercial domicile or principal place of business, and formula apportionment. Of course, all these elements need not be present in any particular state.

(iii) Formula apportionment. Because of the difficulties with separate accounting and with the definition of source rules for corporate income, virtually all states with a corporate income tax use some type of formula apportionment mechanism for determining taxable income from sources within the state. Formula apportionment assigns a portion of a multistate corporation's total taxable income to a particular state based on the relationship between the corporation's activities in that state to its total activities. Income is

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1 The commercial domicile is the corporation's principal place of business and not necessarily the place of incorporation.

apportioned on the basis of a weighted or simple average of the percentages that such factors as payroll, property, and sales within the state bear to the total amounts of these factors. Most, but not all, states use a 3-factor formula based on payroll, property, and sales.

Assume that a corporation has \$100,000 in total taxable income; payroll, property, and sales in state A of \$75,000, \$100,000, and \$300,000, respectively; and total payroll, property, and sales of \$300,000, \$300,000, and \$600,000, respectively. In addition, assume that state A requires that corporate net income be apportioned under the 3-factor formula, with each factor having a weight of one-third. The corporation's taxable income in state A would be equal to:

$$\frac{\frac{75,000}{300,000} + \frac{100,000}{300,000} + \frac{300,000}{600,000}}{3} = \frac{13}{36} = \text{apportionment factor}$$

$$\frac{13}{36} \times \$100,000 = \$36,111 = \text{taxable income attributed to state A}$$

Formula apportionment assumes that the factors used in the formula bear a reasonable relationship to the income earned by the corporation and that the corporation is equally profitable, in relation to the formula's factors, in all areas in which it operates. If these assumptions are incorrect a state may be taxing more or less than the income actually earned within its borders. This is particularly true in the case of dividend income. Although most states provide some relief, either through exemptions or a dividend received deduction (similar to that allowed for Federal purposes), 29 states include some dividend income in the business income to be apportioned. Virtually none of these states, however, allows for the underlying sales, payroll, or property of the paying corporation to be included in the recipient corporation's apportionment formula. [1] This treatment tends to increase the states' tax base; the implications will be explored later in the discussion of foreign source income.

There is little agreement among the states on the specific ingredients of the formula. States differ as to the number of factors in the formula; the weights to be applied to the factors; the type of property to be included in the formula (especially rented property and property for which income is specifically allocated); the valuation

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1/ An exception prevails in those states which require a combined report and calculate state tax using the unitary system.

of property (cost or cost less a depreciation allowance); when, during the tax year, the value of property is determined; whether sales include rental and royalty receipts; whether sales are assigned to individual states on an origin or destination basis; and whether a "throwback" rule is applied. 1/

These differences exist, in part, because the courts have sanctioned a variety of apportionment formulas as reasonably measuring the income attributable to a particular state. In fact, the basic position of the courts has been that an apportionment formula must be patently arbitrary and unreasonable before it will be held to be in violation of the Commerce and Due Process Clauses.

For example, in Butler Bros. v. McColgan, 315 U.S. 501 (1942), an Illinois corporation engaged in general merchandising was assessed a tax liability of nearly $4,000 under the California apportionment formula, although it contended it had a loss of over $82,000 on its California operations. In affirming California's use of an apportionment formula based on payroll, property, and sales, the United States Supreme Court stated:

> One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent evidence' that it results in extra-territorial values being taxed.... At least in absence of proof, California was justified in assuming that the San Francisco branch contributed its aliquot share to the advantages of centralized management of this unitary enterprise and to the net income earned. 2/

Butler Bros. illustrates the position the Supreme Court has adhered to since it first sanctioned the application of formula apportionment to a manufacturing and mercantile business in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920). Formula apportionment is prima facie valid and can be rebutted only if the taxpayer demonstrates that the formula produces an arbitrary

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1/ A throwback rule is sometimes adopted by states that normally apportion sales on a destination basis under which sales are entered into the numerator of the apportionment formula if they have a destination in that state. However, if sales are destined for a state in which they are not taxable, the throwback rule provides that such sales will also be placed in the numerator of the origin state's apportionment formula.

2/ 315 U.S. at 507-509.

and unreasonable result wholly inconsistent with the facts. In Hans Rees' Sons, Inc. v. North Carolina, 283 U. S. 123 (1931) and General Motors v. District of Columbia, 380 U. S. 553 (1965) the Supreme Court found a rebuttal of the presumption that the formulas were reasonable and held that the particular apportionment methods violated the Commerce and Due Process Clauses.

Some states, notably California and Oregon, carry formula apportionment a step further and apply it to the corporate group rather than a single corporation. 1/ This is known as the unitary system of taxation. Assuming a 3-factor formula, the taxable income of a particular corporation in a particular state is determined by relating that corporation's in-state payroll, property, and sales to the total payroll, property, and sales of the unitary corporate group:

> The essence of the California approach is to compute the tax on a corporation with a business location within California by taking into account the assets and activities of affiliated corporations which are not [or may not be] subject to California's tax jurisdiction, but which participate with the corporation in California in conducting a "unitary" business. Such affiliates may include foreign corporations having no income subject to federal tax because they are organized and operated exclusively abroad. 2/

California deems two or more corporations to be part of a unitary business, and thus, subject to formula apportionment if they display all the elements of a unitary business or if they satisfy a "dependency" test. Generally, there are three elements to a unitary business: (1) unity of ownership, presumptively fulfilled if stock ownership of one corporation in another is at least 50 percent: (2) unity of operation as evidenced by centralized purchasing, advertising, and management; and (3) unity of use of a centralized executive force or general system of operation. 3/

1/ According to E. George Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups", Tax Law Review 25, January 1970, pp. 171-211, 23 states have the authority to require combined reporting, but only California and Oregon use the authority to any extent.

2/ Peter Miller, "State Income Taxation of Multiple Corporations and Multiple Business", Taxes, February 1971, p. 104.

3/ Wilbur F. Lavelle, "What Constitutes a Unitary Business", Proceedings of the Twenty-Fifth Tax Institute, 1973, p. 244.

The "dependency" test is satisfied:

> [I]f the operation of the portion of the business done within the state is dependent upon or contributes to the operation of the business without the state. 1/

Dependency may be established by such factors as a flow of goods or centralized purchasing, advertising, or accounting.

The courts have upheld the application of formula apportionment to a multicorporate unitary business in Edison California Stores v. McColgan, 183 P. 2d 16 (1947) and Chase Brass and Copper Corporation v. Franchise Tax Board, 95 Cal. Rptr. 805 (1970).

3. State taxation of foreign source income. Only five states, Delaware, Florida, Georgia, New Hampshire, and Ohio, provide special tax treatment for foreign source income. 2/ In the remaining 41 states with corporate income taxes, the rules for taxing foreign source income are derived from the general statutory rules. These rules are described in detail in Tables 1 and 2 and are only summarized here.

With respect to the five states providing special rules, Delaware provides an exemption for dividends from a non-Delaware corporation, and for interest and royalties for which a foreign tax credit is available under Federal law. Florida provides a blanket exemption for all foreign source income; the exemption presumably extends to foreign branch income. Georgia exempts dividends from sources outside the United States. New Hampshire exempts dividends and interest from at at least 30 percent owned foreign subsidiaries. In Ohio, Subpart F income, foreign source royalties, and foreign source subsidiary dividends are not taxable.

Although it does not provide special rules for foreign income, Michigan is noteworthy because it replaced its corporate income tax with a new tax, the single business tax, effective January 1, 1976. The single business tax bears some resemblance to a value added tax: its base is depreciation incurred, compensation and interest paid, and federal taxable income. However, all dividends, interest, and

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1/ Lavelle, Op. cit., p. 244.

2/ In addition, 34 states make provision for excluding from the state tax base at least part of the Federal gross-up (specified in Section 78) for underlying foreign corporate taxes on foreign dividend income. The gross-up is excluded directly in "nonconforming" states which do not follow the Federal definition of taxable income, and indirectly by either an explicit deduction or by a dividends received deduction in "conforming" states.

royalties received, whether from foreign or domestic sources, are exempt. The base is apportioned according to a fairly typical 3-factor formula. The single business tax law prohibits any attempt to tax foreign source income by requiring a worldwide consolidated return. The operations of a foreign branch are included in the single business tax, both for purposes of computing the tax base and the apportionment formula.

Of the 41 states not providing special rules for foreign source income, 29 provide at least a partial deduction for underlying foreign corporate taxes deemed paid on foreign source dividends. Income is then either specifically allocated or apportioned as described in the following paragraphs.

(a) Dividends. The treatment of dividends is described in columns 2 and 3 of Table 2. Six states, Kentucky, Maryland, Michigan, Missouri, Pennsylvania, and West Virginia exempt all intercorporate dividends. Thus, all dividends from foreign sources are exempt. Fifteen states allow the dividend received deductions provided by Sections 243 and 245 of the Internal Revenue Code. Section 243 permits a U. S. corporation to deduct 85 percent of dividends received from any other U. S. corporation, and 100 percent of dividends received from U. S. corporations in which it has an 80 percent or more ownership interest. Section 245 permits the dividend received deduction for dividends from a foreign corporation which receives at least 50 percent of its gross income from sources effectively connected with a U. S. trade or business. The 15 "conforming" states follow the Federal policy of a general deduction for intercorporate dividends from essentially domestic corporations. Nine states provide a partial deduction for intercorporate dividends received from either domestic or foreign subsidiaries. Several states provide a deduction for intercorporate dividends only if the paying corporation was taxable in the state of the receiving corporation. Dividends that are nonbusiness income are allocated to the recipient's commercial domicile. Dividends that are business income are apportioned. Of course, these rules involve substantial overlap; a state may provide a partial deduction for some subsidiary dividends and specific allocation or apportionment for the remaining portion.

To summarize, it appears that dividends from foreign sources are excluded, in whole or to a substantial degree, from the tax base of 20 states, and are included, in whole or to a substantial degree, in the tax base of 26 states.

(b) Interest. Only Delaware, Florida, and New Hampshire specifically exempt foreign interest income from the state tax base. A few states, such as Maryland, Michigan, or New York, exempt some interest income regardless of source. The remaining states generally allocate all nonbusiness interest, such as interest on portfolio investments, to the recipient's commercial domicile and apportion all business interest, such as interest on accounts receivable, installment contracts, and certificates of deposit. Thus, interest from both foreign and domestic creditors enters the tax base of most states.

(c) Capital gains. According to column 5 of Table 2, few states provide any type of exemption for capital gains. New York exempts gains on the securities of a subsidiary in which a taxpayer has at least a 50 percent ownership interest. Florida exempts gains from foreign sources. Apart from such minor exceptions, all states treat gains as taxable income. A few states, such as Arkansas, Colorado, Massachusetts, and New Jersey, treat gains as apportionable income, but the great majority of states use a combination of specific allocation and apportionment. Nonbusiness gains are specifically allocated in the following ways: on real property, to situs; on tangible personal property, to situs or to the taxpayer's commercial domicile if the taxpayer is not taxable in the state where the property has its situs; and on intangibles, to the payee's commercial domicile. Gains on property used by a taxpayer in its business are considered business income and are apportioned.

Based on these rules, nonbusiness gains on foreign situs real and tangible personal property would almost invariably be excluded from a state's tax base. Nonbusiness gains on intangibles and gains from trade or business property, whether domestic or foreign source, would usually be included in a state's tax base.

(d) Rents. The treatment of rents, described in column 6 of Table 2, is similar to that provided for capital gains. Florida exempts rents earned outside the United States. A few states, such as Delaware, and Louisiana, specifically allocate all rents to the situs of the asset. A few more states, such as Arkansas, Massachusetts, New Hampshire, and Vermont, apportion all rents. The remaining states consider rents as taxable income to be allocated or apportioned. Nonbusiness rents on real property typically are allocated to the situs of the asset, and other nonbusiness rents are usually allocated to the state where the property is used or to the taxpayer's commercial domicile if the taxpayer is not taxable in the state where the property is used. Rents from a taxpayer's trade or business assets, such as excess manufacturing space, and rents generated in the course of the taxpayer's normal business activities, are considered income subject to formula apportionment.

Based on these rules, no state includes rental income earned on nonbusiness foreign situs real property in its tax base. Rents on other nonbusiness property, as well as from the taxpayer's business assets, would ordinarily be included in a state's tax base. However, nonbusiness rents on personal property used in a foreign country might be excluded from the states' tax base, provided the taxpayer was taxable where the property was used.

(e) Royalties. Column 7 in Table 2 describes the tax treatment of royalties. Three states, Delaware, Florida, and Ohio, specifically exempt royalties from foreign sources. Michigan exempts all royalties. A few states, such as Colorado, Connecticut, Montana, and New Jersey treat royalties as income to be apportioned. The remaining states allocate nonbusiness royalties and apportion business royalties. Nonbusiness royalties on real property are typically allocated to the situs of the asset; on personal property such royalties are allocated to the state where the property is used or to the payee's commercial domicile if not taxable where the property is used. According to the criteria applied by the states, royalties are business income if derived from a patent used as an integral part of the payee's business; or if derived from a patent or license used to produce a product made by the payee; or if generated in a business similar to the payee's; or if licensing is a principal business activity of the payee.

Based on these rules, no state would include royalties on nonbusiness foreign situs real property in its tax base. Apart from the foreign source royalty exemptions provided by Delaware, Florida, and Ohio, and the general exemption provided by Michigan, all the states would include nonbusiness royalties on personal property and royalties qualifying as business income in their tax bases. However, nonbusiness royalties on personal property used in a foreign country might be excluded from the states' tax base if the taxpayer is taxable where the property is used.

(f) Branch income. Only Florida provides an exemption for foreign source branch income. The remaining 45 states provide parallel treatment for foreign and domestic source branch income and consider it business income to be apportioned. Thus, the income of the branch, whether foreign or domestic source, is included in the corporation's taxable income to be apportioned. Similarly, the apportionment factors, for example payroll, property, and sales, for both foreign and domestic branches are given full recognition in determining the corporation's apportionment formula.

(g) State taxation of foreign source income under a unitary system. California and Oregon employ a unitary method of taxing the income of corporations doing business in those states. The following analysis is based on the California system.

Where a single enterprise is doing business both inside and outside California, income is apportioned to California under the traditional 3-factor formula (payroll, property, and sales). However, where an enterprise doing business in California controls or is controlled by another corporation, or is related to other corporations by virtue of common ownership, and the degree of common ownership or control is over 50 percent, California requires the controlled group to file a combined report of its worldwide income, if it operates as a "unitary business". A combined report is required regardless whether the parent company, the brother-sister companies, or the subsidiary companies do business in California so long as the group constitutes a "unitary business" under California's rules. A unitary business generally exists where there is (1) a unity of ownership (common ownership); and (2) unity of operation as evidenced by central purchasing, advertising, accounting, and management; and (3) unity of use of a centralized executive force and general system of operation.

The combined report is, in effect, a consolidated return of the controlled group's worldwide income. 1/ California apportions income to the state on the basis of the proportion which the California payroll, property and sales bears to the total worldwide payroll, property and sales of all the related companies.

For example, suppose U. S. parent corporation A and wholly owned subsidiaries B and C form a unitary business and are engaged in the business of manufacturing and selling lathes. Corportion A manufactures lathes and does no business outside California. Corporation B sells lathes in California and other states, while Corporation C sells the lathes abroad and does no business in the United States. Since CorporationsA, B, and C are a unitary group, a separate but combined return must be filed for Corporation A and Corporation B, each of which does business in California. Although Corporation C is not required to file a return in California, its income and apportionment factors are included in the combined return of the unitary group. The total income is apportioned to California by a 3-factor formula. Suppose that the payroll, property, sales and taxable income for these corporations are as follows:

Corporation	Payroll		Property		Sales		Taxable
	Total	Calif.	Total	Calif.	Total	Calif.	Income
A	120	120	180	180	240	240	50
B	80	40	120	60	160	80	50
C	100	0	150	0	200	0	80
	300	160	450	240	600	320	180

Corporation A's taxable income in California under the unitary approach would be computed as:

$$\frac{120}{300} + \frac{180}{450} + \frac{240}{600} = 0.40 = \text{unitary apportionment factor}$$

$0.40 \times 180 = 72$ = taxable income in California

1/ The combined profit and loss statement excludes intercompany sales and income payments in order to avoid double counting.

Corporation B's taxable income in California under the unitary approach would be computed as:

$$\frac{40}{300} + \frac{60}{450} + \frac{80}{600} = 0.133 = \text{unitary apportionment factor}$$

$$0.133 \times 180 = 24 = \text{taxable income in California.}$$

In the context of multinational business operations, California does not limit its requirement of a combined report to enterprises controlled in California or even in the United States. Affiliated groups of foreign corporations having a California subsidiary must file a combined report where the business has a "unitary" character.

III. ANALYSIS

State taxation of foreign source income, as defined by Federal law, creates the possibility of double or extraterritorial taxation; it can reduce the Federal tax base; and in some circumstances it may raise significant administrative problems. These aspects are examined as they arise under the specific allocation method, formula apportionment, and the unitary system. To the extent states exclude foreign source income from taxation, the problems do not arise.

1. Specific allocation method. The 46 states with corporate income taxes allocate certain items of nonbusiness income to a specific geographic source, usually on the basis of the situs of the property, the extent of its use, or the taxpayer's commercial domicile, and divide business income between jurisdictions on the basis of apportionment formulas (see Table 2). The states differ, of course, in how they define nonbusiness and business income. Income that might be allocated by one state could be apportioned by another. Delaware, Florida, New Hampshire, Georgia, and Ohio exempt some items of foreign source income, and are the only states to provide special rules for the tax treatment of foreign source income.

In the remaining 41 states, any taxation of foreign source income results from the application of the general rules for taxing a multistate corporation. Based on these rules, the following items of foreign source nonbusiness income are included in the tax base of a significant number of states: dividends; interest; capital gains from intangible personal property; and rents and royalties from personal property.

(a) Double taxation. Double taxation, defined in its broadest terms, occurs when the same income is taxed by two or more jurisdictions. In this sense, double taxation regularly occurs between the states and the Federal government , although the Federal deduction for state taxes ameliorates the extent of double taxation. It also occurs between states when their methods of dividing the income of a multistate corporation do not mesh. Double taxation between the Federal and foreign governments is addressed by the foreign tax credit provisions of Federal law.

For present purposes, double taxation is defined more narrowly to occur whenever two or more jurisdictions tax the same income in such a manner that the taxpayer has a total tax burden that exceeds the higher of the tax burden levied by all jurisdictions within the geographic source of his income or the tax burden levied by all jurisdictions within the taxpayer's own place of residence. Thus, if the combined taxes of states, the Federal government, and foreign governments on foreign source income exceed on the one hand the tax burden imposed by states and the Federal government on domestic source income, and on the other hand the tax burden imposed by the foreign government alone on foreign source income, double taxation may be said to occur. This narrow type of double taxation is illustrated in Case IA of Table 4. Similarly, this narrow type of double taxation also exists between the states if the combined taxes levied by the Federal government and the states exceed the combined Federal and state taxes that would be levied if the corporation operated in only one state.

In the context of state taxation of foreign income, the operation of specific allocation rules creates the possibility of two similar kinds of double taxation. In the first place, when the domiciliary state provides no credit for foreign taxes, foreign source income may be taxed at a higher rate than in either the source or residence jurisdictions. In the second place, the income might be taxed both in the domiciliary state under specific allocation rules and in some other state under formula apportionment or a unitary system.

For example, since Illinois allocates foreign source nonsubsidiary dividends, portfolio interest, and some capital gains to Illinois when received by a corporation whose commercial domicile is in Illinois, double taxation may arise if this income also is taxed at its foreign source. Foreign source income also may be taxed by two or more states. For example, Illinois apportions foreign source subsidiary dividends as business income, but Indiana allocates them entirely to that state if the recipient corporation has its commercial domicile in Indiana. Therefore, a corporation domiciled in Indiana, but also doing business in Illinois, would find that any subsidiary dividends it received from foreign sources would be taxable in full in Indiana and a portion of the dividends would again be subject to tax in Illinois.

These examples are not unique. Double taxation regularly occurs because the states do not provide a credit for foreign taxes paid in excess of the amount creditable under Federal law. 1/ Double taxation also occurs because states do not have a uniform system for allocating and apportioning income among them, and, with the exception of Alabama, do not provide a credit for taxes paid other states. Thus, a multistate corporation will be subject to double taxation whether or not it has foreign operations.

1/ A state credit for excess foreign taxes would, of course, be limited by the combined rate of state and Federal taxes on foreign source income. While no such credit is provided, as shown in Table 1, most states do allow a deduction for at least some foreign income taxes.

Fifteen states allow the dividend received deduction provided by Federal law. This deduction applies mainly to dividends from domestic corporations; dividends from foreign corporations are eligible only if received from a corporation with significant gross income effectively connected to a U. S. trade or business. Several more states exempt intercorporate dividends from corporations taxable in the state where the payee is domiciled. Thus, in these states, intercorporate dividends from foreign sources will be included in the state's tax base to a greater extent than if the dividends were received from corporations operating mainly within the United States.

(b) Reduction of the Federal tax base. Whenever foreign income is taxed by a state, a deduction is created which may be claimed in computing Federal taxable income. Again, in this respect, there is no difference between state taxation of domestic income and state taxation of foreign income. Any state or local tax reduces the Federal tax base.

The new issue raised by state taxation of foreign income is whether this tax base should be reserved to the Federal Government. It might be argued that to the extent foreign source income is taxed at all, it should be taxed for the benefit of all the people of the United States and not for the benefit of a particular state. The income is earned abroad, and does not depend upon, or benefit from, state protection or expenditures.

On the other hand, the United States taxes its residents on their worldwide income. By analogy, it can be argued that the individual states should be permitted to tax their residents on worldwide income. Under this view, it makes no difference whether states tax foreign income deliberately through a specific allocation procedure or inadvertently through a malfunctioning formula apportionment. In both cases, states should be permitted to tax foreign income.

(c) Administrative problems. The specific allocation method does not create substantial administrative problems for the corporate taxpayer. The income is either entirely allocated to the state, or entirely allocated to another jurisdiction. However, with any specific allocation method, state tax administrators must be concerned about erosion of the tax base, and consequent loss of revenue, through artificial transfer pricing.

2. Formula apportionment. In taxing a multistate corporation or a multinational corporation, each state faces the problem of assigning a "reasonable" proportion of the corporation's total taxable income to the state. A "reasonable" proportion generally means that the state will seek to tax only that part of a corporation's income that is generated within its borders. The United States faces a similar problem in taxing multinational corporations. Thus, the Internal

Revenue Code sets forth detailed source rules and arm's length pricing procedures. Such an approach would strain the administrative capability of many states. A frequently used device at the state level, therefore, is to apportion business income in relation to the corporation's activities in the particular state. The question raised by formula apportionment is whether in addition to serving as a convenient measuring device, it has the side effect of enabling the states to tax foreign source income, as defined by Federal law.

(a) Double taxation. As shown in Table 2, each of the 46 states which levies a corporate income tax subjects at least some of the following items of business income to formula apportionment: dividends, interest, capital gains, rents, and royalties. With few exceptions, this treatment applies uniformly to income from foreign and domestic sources.

While state apportionment formulas are not uniform, it is fairly typical to use a 3-factor formula involving payroll, property, and sales, with each factor having a weight of one-third. Assume that the ABC corporation, which is taxable in New Jersey, has New Jersey payroll, property, and sales of \$100,000, \$200,000 and \$500,000, respectively, and total payroll, property, and sales of \$300,000, \$600,000 and \$1,500,000, respectively. Thus the apportionment factor would be:

$$\frac{\dfrac{\text{New Jersey Payroll}}{\text{Total Payroll}} + \dfrac{\text{New Jersey Property}}{\text{Total Property}} + \dfrac{\text{New Jersey Sales}}{\text{Total Sales}}}{3}$$

$$\frac{\dfrac{100,000}{300,000} + \dfrac{200,000}{600,000} + \dfrac{500,000}{1,500,000}}{3} = \frac{1}{3} = \text{apportionment factor}$$

If the the corporation received \$100,000 in royalties from either a domestic or foreign subsidiary, one third of that, or \$33,333 would be apportioned to and taxable in New Jersey. Thus royalty income from a foreign subsidiary would be taxed both in New Jersey and abroad, but royalties from a domestic subsidiary might also be taxed both in a sister state, and in New Jersey. This form of double taxation occurs regularly because the state apportionment formulas, except in the case of branch income and except under a unitary system, do not give recognition to the subsidiary payroll, property, and sales that generate business income in the form of capital gains, dividends, interest, rents, and royalties.

Some states do include selected items of business income in the denominator of the apportionment formula. This has the effect of reducing the size of the apportionment factor. Such an approach mitigates, but does not eliminate double taxation. Moreover, it is difficult to find a logical reason for this particular adjustment. An apportionment formula seeks to divide income, usually, on the basis of a corporation's payroll, property, and sales inside and outside the taxing jurisdiction. It thus seems inappropriate to include an income item in the denominator of the formula.

Formula apportionment does not always create double taxation. It may reduce a state's tax base. This is particularly true of branch income. Virtually all states applying formula apportionment include the income and relevant apportionment factors of both foreign and domestic branches in the apportionment calculation for the parent. 1/

Continue the example of the ABC corporation which had an apportionment factor of one-third. If the corporation had taxable income of $300,000, then $100,000 of that would be apportioned to New Jersey. Now assume that the ABC corporation opens a new branch, either foreign or domestic, but outside New Jersey, that earns $60,000 in taxable income and has payroll, property, and sales of $100,000, $200,000, and $500,000, respectively. The ABC corporation's apportionment formula would then be:

$$\frac{\frac{100,000}{300,000+100,000} + \frac{200,000}{600,000+200,000} + \frac{500,000}{1,500,000+500,000}}{3}$$

$$= 1/4 = \text{apportionment factor with new branch}$$

The ABC corporation now has $360,000 of taxable income that is subject to apportionment, the original $300,000 plus the $60,000 from the branch. It also has a smaller apportionment factor, 1/4, rather than 1/3, since the formula recognizes the activities of the new branch. The taxable income which the ABC corporation actually apportions to New Jersey is:

$$\$360,000 \times 1/4 = \$90,000.$$

In this example, the branch earnings, whether foreign or domestic, serve to reduce the New Jersey tax base. This result is produced by a special assumption; namely, that the new branch's ratio of its taxable income to its payroll, property, and sales is less than the ratio of the rest of the ABC corporation's taxable

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1/ The exception is Florida which apparently exempts foreign branch income.

income to its payroll, property, and sales. Of course, if branch operations are more profitable than the corporation's other operations, the ratio of branch income to its payroll, property, and sales would be greater than the corresponding ratio for the rest of the corporation and some branch income would be apportioned to and taxable in New Jersey. The ultimate result depends on how profitable branch operations are relative to the rest of the corporation. Formula apportionment applied to branch operations may thus increase or decrease a state's tax base.

Formula apportionment can also lead to double taxation between states (or a reduction of the states' tax base) because of the failure of state apportionment formulas to mesh properly. Foreign or domestic source income will then be victim to the lack of uniformity in apportionment formulae. Assume that a corporation has foreign subsidiary dividend income of $100,000; that the corporation is engaged in business both in state A and state B; and that the income is apportioned by each of the states. Assume further, to keep the example simple, that the two states use only a property factor in the apportionment formula. State A values property at cost, while state B at cost less depreciation. The property values for the corporation are:

	State A	State B	Total
Cost	$10 million	$15 million	$25 million
Cost Less Depreciation	$ 5 million	$15 million	$20 million

The property in state B has just been put into service and has therefore incurred no depreciation.

The $100,000 in foreign subsidiary dividend income is apportioned as follows:

State A
(Property Valued at Cost)

$$\frac{10}{25} \times \$100,000 = \$40,000$$

State B
(Property Valued at Cost Less Depreciation)

$$\frac{15}{20} \times \$100,000 = \underline{\$75,000}$$

Total Apportioned Foreign Dividend Income	$115,000

Because of differing apportionment formulas, the two states apportion more than the $100,000 in foreign subsidiary dividend income. Clearly, the two states are subjecting some of the foreign subsidiary dividend income to double taxation, in the sense that it bears a higher tax burden than if it had been allocated to one of the two states rather than apportioned between them. This type of double taxation results from differences in the state apportionment formulas. It can and does occur with respect to many items of income from both foreign and domestic sources.

(b) Reduction of the Federal tax base. The apportionment of domestic and foreign investment income (dividends, capital gains, interest, rents, royalties) usually leads to additional taxation at the state level. This happens because the apportionment factor reflects only the activities of the receiving corporation and does not reflect the activities of the paying corporation. 1/ Since state taxes are a deductible expense, the Federal tax base is correspondingly reduced.

The apportionment of domestic and foreign branch income may either increase or reduce taxation at the state level. An increase in state taxation would diminish the Federal tax base; a decrease in state taxation would enlarge the Federal tax base. On average, it seems likely that foreign branches are as profitable as domestic investments. Thus, apportionment of foreign branch income probably does not lead to a substantial net increase or decrease in the Federal tax base.

(c) Administrative problems. Formula apportionment was initially devised to bypass the difficulties of a source rule approach. It resolves many transfer pricing questions which would otherwise concern state tax administrators. But by comparison with a specific allocation method, formula apportionment may be more complicated for taxpayers.

3. Unitary system. Under a unitary system, the total domestic and foreign business income of the controlled corporate group is apportioned for tax purposes. Unlike other methods, the unitary system apportions the undistributed income of a foreign subsidiary corporation, the income of a foreign parent corporation and the income of foreign brother-sister corporations.

1/ Except under a unitary system.

The unitary system evolved from the application of formula apportionment to the activities of a single, multistate corporation. Formula apportionment was upheld by the United States Supreme Court in Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 (1920). In discussing the taxpayer's appeal the Supreme Court said:

> The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sales in other states. In this it was typical of a large part of the manufacturing business conducted in the state. The legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach only the profits earned within the state. 1/ (Emphasis added.)

In sustaining formula apportionment, the Court was clearly aware of the difficulty of separately accounting for the profit earned in the various stages of an integrated manufacturing and distributing operation.

The Franchise Tax Board of the state of California contends that, since it may be similarly impossible to separately identify the profits earned by individual corporations in a unitary group, the unitary method is justified.

> The use of a combined report (unitary method) for determining income is not based upon the concept that members of a unitary group have not acted at arm's length. It is used because separate accounting, regardless of its mathematical accuracy, does not properly reflect the income of a unitary business. For example, assume one corporation manufactures an item which is sold by another wholly owned corporation and that the combined net income is $1 million. In such cases, should it matter if separate accounting records reflect that one corporation earned $3 million and that the other corporation lost $2 million? 2/

1/ 254 U.S. at 120-121.

2/ "Staff Observations Regarding Income Tax Provisions of Legislative Proposals," California State Franchise Tax Board, State Taxation of Interstate Commerce, Hearings before the Subcommittee on State Taxation of Interstate Commerce of the Committee on Finance, United States Senate, 1973, p. 299.

Similarly, the California Supreme Court, in unanimously approving the combined report procedures, stressed the interdependence of a unitary business and questioned the relevance of separate accounting:

> [W]hen the business is not separate, and is an integral part of a larger and unitary system, the separate accounting is inadequate and unsatisfactory in ascertaining the true result of the activities and values attributable to that business. 1/

Other commentators, such as Frank M. Keesling, former Counsel for the California Franchise Tax Commissioner, have argued that the combined report is necessary to confront the loss of tax revenue resulting from unrealistic transfer pricing. 2/

(a) Double taxation. The unitary system may either increase or decrease a state's tax base compared to separate accounting between corporations and formula apportionment applied to the activities of a single corporation. It may result in either higher or lower taxation of a corporation compared to what the corporation's taxable income would be if it was not a member of a combined group.

Consider the earlier example where U.S. parent corporation A and wholly owned subsidiaries B and C are engaged in the business of manufacturing and selling lathes (Section II(3)(g) above). Corporation A would have a taxable income of $72 under the unitary method, but $50 under separate accounting. In this instance, the inclusion of corporation B (a domestic subsidiary) and corporation C (a foreign subsidiary) in corporation A's combined report serves to increase corporation A's California tax liability. 3/

It could be argued that, since California is taxing more than corporation A's total income, it is necessarily taxing income earned outside its borders and that double taxation may consequently arise. Alternatively, it could be argued that there is no realistic way

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1/ Edison California Stores v. McColgan, 183 P.2d 16 at 21 (1947).

2/ Frank M. Keesling, "A Current Look at the Combined Report and Uniformity in Allocation Practices", Journal of Taxation, February, 1975, pp. 106-110.

3/ Corporation B's taxable income in California is decreased by the combined report requirement: it would be 25 under separate accounting; 24 under the combined report.

to separate corporation A's taxable income from that of its wholly owned subsidiaries, corporations B and C, which also manufacture and sell lathes, and that the combined report provides a reasonable method of assigning an appropriate percentage of the corporate group's total earnings to California. The crux of the debate over the unitary system is whether it systematically increases the state's tax base in the face of more reasonable alternatives.

In Edison California Stores v. McColgan, 183 P. 2d 16 (1947), the California Supreme Court was faced with the question of whether formula apportionment could be applied to an entire corporate group. The parent corporation, which was incorporated in Delaware with headquarters in St. Louis, Missouri, provided centralized purchasing, distribution, advertising, and management for its 15 wholly owned subsidiary retail stores operating in various states. The only activities in California were carried on by the taxpayer corporation, a wholly owned subsidiary which operated retail stores within the state. In approving the application of formula apportionment to the corporate group as a reasonable means of determining the in-state income of the California subsidiary, the court found the same operational interdependence which it found earlier in Butler Brothers vs. McColgan 111 P. 2d 334 at 336 (1941):

> It is only if its business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used. Where, however, interstate operations are carried on and that portion of the corporation's business done within the state cannot be clearly segregated from that done outside the state, the unit rule of assessment is employed as a device for allocating to the state for taxation its fair share of the taxable values of the taxpayer. [1]

Thus, when the parts of a multicorporate group are interrelated, the court found it reasonable to assume all parts are equally profitable and to apply formula apportionment to the entire group.

Some commentators, however, contend that in recent years the California courts have broadened the definition of unitary

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1/ 183 P. 2d at 20.

operations.1/ For example, in Chase Brass and Copper Company v. Franchise Tax Board 95 Cal. Rptr. 805 (1970) the California Court of Appeals approved the state's attempt to combine Kennecott Copper Corporation with its wholly owned subsidiary Chase Brass. Kennecott mined copper in Utah, Nevada, Arizona, and New Mexico, but did no manufacturing in California and had no contacts of its own in the state. The court relied on such factors as: Chase Brass purchased about 20 percent of Kennecott's copper output at an arm's length price for use in its manufacturing operations; Kennecott made a large loan to Chase, at the prime rate, to rebuild its plant; and Chase executives reported to the President of Kennecott on major policy matters. The application of unitary reporting increased Chase Brass' California taxable income by thirteen times.

Leo Brockett, in anaylzing the court's decision in Chase Brass, contends that, although the court based its findings on a unity of ownership, operation, and use, the factors leading to a unitary determination in this case would be present in almost any parent-subsidiary relation. Similarly, John Nolan has observed that "while unity of use and operation, or dependency of contribution between in-state and out-state business is theoretically required, California in fact seems to require little more than the normal attibutes of common ownership." 2/

(b) Reduction of the Federal tax base. To the extent that the unitary system results in higher state taxation of foreign or domestic source income, the Federal tax base will be diminished. On the other hand, to the extent that the unitary system results in lower taxation by the state of foreign or domestic income, the Federal tax base will be enlarged.

(c) Administrative problems. A frequently voiced criticism of the unitary system is the administrative burden which it imposes on taxpayers, particularly when it is applied to a corporation organized in a foreign country. This criticism is sharpest when the activities of a foreign controlled group are brought within the unitary system because it has a subsidiary in a unitary state, such as California, but the activities of the subsidiary are a relatively small portion of the foreign group's total activities.

1/ See, for example, Leo Brockett, "Chase Brass and Copper Co. v. Franchise Tax Board: Intercorporate Unity and State Income Taxation", California Western Law Review, Spring 1971, pp. 508-521 and John S. Nolan, "Extension of the California Unitary Business Concept", in State Taxation of Interstate Commerce, 1973, pp. 433-437.

2/ Nolan, Op. cit., p. 434.

A combined report necessitates the computation of a taxable income figure, as defined by state law, for each corporation in the group. Each corporation must provide data on its payroll, property and sales, with intercompany sales eliminated. Critics contend that, because of differences in accounting periods and practices, this information requires a completely new set of calculations and imposes a substantial administrative burden on foreign corporations. Indeed, it is argued that a corporation operating within the United States, but outside a unitary state such as California, may also have administrative problems because of differences in how the states define net income. Finally, some observers have questioned the wisdom of applying the 3-factor formula to a foreign corporation since differences that exist between states with respect to the ratio of income to the three factors are likely to be magnified when a foreign country is included in the apportionment.

The essence of the administrative burden argument is that, while formula apportionment may be a useful tool with respect to one corporation, it is not useful with respect to a corporate group. When applied to a single multistate corporation, formula apportionment avoids the need to construct separate sets of accounts for the corporation's activities in each state. But, with two or more corporations the separate accounts already exist; therefore, continues the argument, the rationale for formula apportionment no longer exists. If the corporate accounts do not accurately reflect income, the solution, it is urged, is through reallocating income and expenses, as provided by Section 482 of the Internal Revenue Code, rather than through formula apportionment.

Proponents of the unitary system disagree strongly. They feel it is difficult to enforce a transfer pricing statute, particularly at the state level, because of an inability to obtain the information needed to assess the transactions of a corporate group with operations in many states and countries. Moreover, they question the underlying meaning of separate accounts within a corporate group, preferring instead to assume that each member of the corporate group earns, or should earn, the same rate of return. Thus, the advocates of the unitary system feel it is sound both administratively and conceptually.

(d) Treaty implications. A basic tax treaty position of the United States and other developed countries is that an enterprise should be taxable in a country on its business profits only if it carries on business in that country through a branch or similar permanent establishment. This principle is enunciated in Article 7 of the Model Income Tax Treaty of the Organization for Economic Cooperation and Development as well as all the income tax treaties of the United States.

The worldwide application of the unitary system may be inconsistent with this principle. This is particularly true when it is applied to the multinational activities of a foreign parent having a subsidiary in a unitary state, such as California. Combining the parent and its other subsidiaries with the California subsidiary can be viewed as taxing enterprises that have no permanent establishment in the United States.

> Taxation by a state based on income of a foreign non-resident parent company from outside the U.S. which is owned and controlled by non-U.S. shareholders living outside the U.S. is beyond accepted bounds of jurisdiction. 1/

State taxation of foreign source income under the unitary system would be restricted by an income tax treaty between the United States and the United Kingdom which was signed December 31, 1975, and amended May 3, 1976. Article 9, Paragraph 4 of the treaty, which must still be approved by the United States Senate and the United Kingdom House of Commons, provides that a state which is assessing the income of an enterprise doing business in that state may not take into account any income or expenses of a related company which is a resident of the United Kingdom or any other foreign members of the same corporate group.

However, this restrictive rule will apply only if certain restrictive conditions are met.

First, the enterprise doing business in, for example, California must be either a resident of the United Kingdom (i.e., a branch of a United Kingdom company operating in California) or be controlled, directly or indirectly by a United Kingdom resident (i.e., a United States corporation which is a subsidiary of a United Kingdom corporation).

Second, where the United Kingdom resident is a corporation, such corporation must be neither controlled by a United States corporation nor by a corporation which is a resident of a third state.

Third, no United Kingdom or third country enterprise which is related to a United States subsidiary doing business in California would be excluded from California unitary apportionment calculations under the treaty if that enterprise is controlled by the United States subsidiary.

1/ Nolan, Op.cit., p. 435.

A few examples may clarify how the rule would operate.

If a subsidiary of a United Kingdom corporation is doing business in California, and that United Kingdom parent corporation has subsidiaries in France and Germany, California would be prohibited from including in its unitary apportionment base the income or expenses of the United Kingdom parent or its subsidiary corporations in France or Germany.

However, if the United Kingdom corporation is itself controlled by, say, a New York corporation, or by a Dutch corporation, California may take into account the income and expenses of the entire group--the United Kingdom corporation, the French and German subsidiaries and the Dutch or New York parent.

4. Revenue estimates. Table 3 presents rough estimates of the 1972 revenue impact of state taxation of foreign source income. Based on present law in the 46 states with a corporate income tax, an attempt was made to estimate the amount of various types of foreign source income presently included in state taxable income. It was assumed that, on average, the unitary systems do not result in the inclusion of foreign income in the state tax base. The net inclusion or exclusion will, however, differ from company to company. 1/ It was also assumed that the apportionment of foreign branch income does not, on average, affect the state tax base.

According to the estimates in Table 3, approximately $3,450 million of foreign income was included in the 1972 tax base of all states. State taxes derived from this income were approximately $190 million. The deduction claimed for state taxes would have reduced Federal tax revenue by about $90 million. A rough extrapolation to 1976 suggests that state revenues on foreign income were approximately $410 million, and that the consequent reduction in Federal revenue was about $200 million.

1/ According to California tax authorities, the worldwide application of the unitary system produces about $125 million in state tax revenue. The basis of this estimate is unknown, and the estimate itself appears to conflict with the California claim that the purpose of the unitary system is to measure California income, and not to tax foreign source income as defined for Federal tax purposes.

Table 3

Revenue Impact of State Taxation of Foreign Income 1/
(millions of dollars)

Types of Foreign Income	Total	Included in Tax Base of States 2/
1972 Estimates		
Subsidiary dividends	$ 4,400	$ 2,200
Portfolio dividends	680	520
Interest	360	350
Rents and royalties	830	380
Total	$ 6,270	$ 3,450
Impact on state tax revenue 3/		190
Impact on U.S. tax revenue 4/		-90
1976 Estimates		
Impact on state tax revenue 3/		410
Impact on U.S. tax revenue 4/		200

Office of the Secretary of the Treasury
Office of Tax Analysis
December 15, 1976

Sources: Joint Committee on Internal Revenue Taxation, Taxation of Foreign Source Income: Statistical Data September 30, 1975, Table C-2. Advisory Commission on Intergovernmental Relations, Federal-State-Local Finances: Significant Features of Fiscal Federalism, November 1975, Table 23; Statistical Abstract of the United States, U.S. Department of Commerce, Bureau of the Census, p. 267.

1/ With the exception of subsidiary dividends, these figures are gross of foreign and Federal taxes because states typically do not allow a deduction for these taxes. Three-fourths of the gross-up for the underlying corporate tax on foreign subsidiary dividends is eliminated because approximately three-fourths the states allow it as a deduction.

2/ The amount actually included in the taxable income of corporations domiciled in a given state depended on the state's tax law.

3/ Based on state corporate income tax rates for 1975.

4/ Based on the U.S. statutory rate of 48 percent.

IV. OPTIONS

State taxation of corporate foreign source income raises three areas of concern. First, it may lead to double taxation, that is, to a combined foreign, Federal, and state tax liability in excess of what the corporation would pay if subject to taxation only in the source jurisdiction or only in the residence jurisdiction. Second, it can reduce the Federal tax base. Third, it may create unnecessary complexity in the tax system.

Some of these problems exist both with respect to state taxation of foreign source income and with respect to state taxation of income arising in another state. Thus, rules relating solely to the taxation of foreign source income would ignore the fundamental problem of double taxation among the states. The Congress has considered dealing with this general question a number of times, but has been unable to devise acceptable rules. The options discussed here are principally addressed to state taxation of foreign income.

1. Retain present law. This option would recognize the jurisdiction of states to tax foreign source income and permit states to continue devising their own systems of taxation. This option is attractive to those who argue that there is no compelling reason for state tax systems to treat foreign source income differently than out-of-state income generally. While it would not correct any difficulties with existing tax methods, this option would spare Congress from involvement in state tax decisions.

2. Prohibit residence states from taxing foreign income. Under this option, a state which was taxing corporate income solely on the basis of tax residence would no longer be permitted to tax foreign source income, as defined by Federal tax law. However, a state which was taxing corporate income on the basis of commercial or legal domicile could include foreign source income in its tax base. A residence state could not include foreign assets, payroll, or sales of a U. S. corporation in its apportionment formula, and whatever formula it used, foreign source income, as defined by Federal tax law, would not be subject to apportionment.

The main virtue of this approach is that it would preclude residence states from subjecting foreign source income to state taxation, either deliberately or inadvertently through the hazards of a particular apportionment formula. In fact, the states taxing on the basis of residence now claim that their formulas are designed only to reach in-state income. To the extent this is true, this option would involve little or no revenue change from the present system.

Under this option, nonbusiness corporate foreign income could still be taxed by domiciliary states; to this extent, double taxation could still exist between individual states and foreign countries. Whether or not business type corporate foreign income was taxed would depend on the mechanics of state apportionment formulas. If this was a problem, this option could be expanded to include a uniform, Federally-prescribed apportionment formula.

3. Prohibit the application of the unitary system to foreign corporations. This option was advocated by the Willis Committee, the Committee on Interstate Taxation of the New York State Bar Association, and the Mathias-Ribicoff Bill (S. 1245, 93d Cong. 1st Sess.). It also received serious consideration during the 94th Congress by a special House Ways and Means Committee Task Force. This option would be aimed at one of the main concerns of the business community, the worldwide application of the unitary tax system. States would be prohibited from including the activities of a foreign parent, brother-sister, or subsidiary corporation in a combined report.

This option would meet the objections that the world-wide application of the unitary system results in the taxation of foreign source income, even before it is repatriated as dividends, and presents taxpayers with insuperable administrative difficulties. This option would not relieve the double taxation that exists in the nonunitary states. State tax administrators who favor the world-wide application of the unitary system respond that this option would force them to verify the transfer prices at which intercorporate transactions are reported. They argue that they lack the necessary resources to enforce a system of separate accounting at arm's length prices and, therefore, they would be victim to transfer pricing abuses and loss of revenue.

Assuming that the unitary system is a device to measure California income, and not a device to tax foreign income, prohibition of the unitary system should involve little or no revenue change. However, California tax authorities have suggested that State tax revenues would decline by $125 million without the unitary system. The basis of this estimate is unknown.

4. Require a state foreign tax credit. Under this option, states would be required to provide a credit for foreign taxes which exceed the Federal foreign tax credit. The credit would, however, be limited to the tentative state tax liability on the foreign income. This option is illustrated by Table 4. Assume corporation A, commercially domiciled in state A, has a wholly owned foreign subsidiary in country X which earns $1,000,000 net income before tax. In addition, assume the U.S. Federal tax rate is 48 percent, the state A tax rate is 5 percent, and that the foreign subsidiary's

Table 4

Example Illustrating impact of Federal or Federal and State Foreign Tax Credits on $1.0 Million of Foreign Source Income under Alternative Tax Rates

	Foreign	Domestic: Federal	Domestic: State A	Total
Case IA				
Tax rates	55%	48%	5%	
Tentative tax liability 1/	$550,000	$480,000	$50,000	
Less:				
Foreign tax credit (Federal only)	------	480,000 2/	------	
Equals:				
Actual tax liability	$550,000	0	50,000	$600,000
Case IB				
Tentative tax liability 1/	$550,000	$480,000	$50,000	
Less:				
Foreign tax credit: (Federal and State)		480,000 2/	$550,000 - 480,000 = $70,000 but limited to $50,000 3/	
Equals:				
Actual tax liability	$550,000	0	0	$550,000
Case IIA				
Tax rates	45%	48%	5%	
Tentative tax liability 1/	$450,000	$480,000	$50,000	
Less:				
Foreign tax credit (Federal only)		450,000 2/		
Equals:				
Actual tax liability	$450,000	$ 30,000	$50,000	$530,000
Case IIB				
Tentative tax liability 1/	$450,000	$480,000	$50,000	
Less:				
Foreign tax credit (Federal and State)		$450,000 2/	$450,000 - 450,000 = 0	
Equals:				
Actual tax liability	$450,000	$ 30,000	$50,000	$530,000

1/ Foreign source income of $1.0 million multiplied by the jurisdiction's tax rate.
2/ The Federal foreign tax credit is always the lesser of the U.S. tentative tax liability on that income or foreign taxes actually paid.
3/ The state foreign tax credit would only apply to foreign taxes not credited at the Federal level. However, like the Federal foreign tax credit, it also would be limited by the state's tentative tax liability on that income. No state, would be required to pay a refund for foreign taxes paid.

entire net income for the year is repatriated as a dividend. Table 4 shows the effects of Federal only and combined Federal and state foreign tax credits under alternative foreign tax rates.

In Case IA and Case IB the foreign tax rate is 55 percent. If only a Federal foreign tax credit is available, corporation A would incur a total, foreign, Federal, and state tax liability of $600,000. Double taxation, as narrowly defined in this paper, has occurred because the $600,000 tax liability is higher than corporation A pays at either the foreign source ($550,000) or the combined tax burden of the Federal and state residence jurisdictions ($530,000). As shown in Case IB, a state foreign tax credit, limited to foreign taxes not credited at the Federal level, and further limited by the state's tentative tax liability, would eliminate this double taxation. Corporation A would have a total tax liability of $550,000 or the higher of its source or residence tax liability. Cases IIA and IIB show the result if the foreign tax rate is less than the domestic tax rates. In these cases, state A collects a residual tax after the tax credit.

This option would eliminate double taxation and would preserve the Federal tax base. However, it would entail substantial administrative complexity to achieve some of the same results as an exemption rule applied to those states which tax a corporation solely on the basis of its residence (Option (2) above). For example, it would require specifying the amount of foreign source branch or unitary corporate income in a state's tax base for purposes of determining the tentative tax against which excess foreign tax credits would be allowed. One possibility would be to assume, in the absence of a statutory exemption, that foreign income of a corporation was taxed in direct relation to the size of the taxpayer's state apportionment formula. However, unlike a residence exemption rule, an excess credit rule would also apply to domiciliary states, and it would leave a residual tax jurisdiction to residence states with respect to foreign source income. Since states do not provide a credit for taxes paid other states, this option could result in more favorable treatment for multinational than for multistate corporations. Under this option, state tax revenues might decline by as much as $410 million while Federal taxes might increase by $200 million. This assumes, however, that foreign taxes exceed combined Federal and state taxes.

5. Require a deduction for foreign income taxes. This option would require the states to provide a deduction for foreign source income taxes paid on foreign source income in computing the state tax base. Since 19 states specifically provide a deduction for foreign taxes deemed paid on the underlying corporate foreign source income, this option could be viewed as an extension of existing policy. While the deduction would reduce double taxation, its impact would be uneven.

On income earned in countries with tax rates in excess of the combined Federal-state rate in the United States, the taxpayer would still have a combined foreign, Federal, and state tax liability in excess of what would be paid on either a source or residence basis. Alternatively, if the foreign tax rate is below the Federal rate, the deduction would tend to treat a taxpayer's foreign source income more favorably than its domestic source income. This would be particularly true in those 37 states which provide no deduction for Federal income taxes in determining a corporation's tax liability. This option, like the credit provision, would also require an administrative determination of a taxpayer's foreign source branch or unitary group income against which foreign taxes were to be deducted. Based on an average foreign corporate tax rate of 48 percent and an average state corporate tax rate of 5.6 percent, this option would reduce state tax revenues by about $90 million and increase Federal tax revenues by about $45 million.

6. Exempt foreign source income by treaty. Bilateral tax treaties could be utilized to eliminate the double taxation of income derived from a particular foreign country. The most far reaching approach would require individual states to exempt foreign source income which was subject to tax in the treaty country.

The treaty approach could also be used to resolve specific administrative problems between a state and residents of another country. This is illustrated by the provision contained in Article 9 of the proposed treaty between the United States and the United Kingdom.

The revenue impact of this option would depend on the particular treaties negotiated and their scope.

7. Exempt foreign source income by statute. In 1973, Senators Mathias and Ribicoff introduced a bill (S. 1245, 93d Cong. 1st Sess.) which would have effectively excluded income from sources outside the United States, as defined by the Internal Revenue Code, from the tax base of the states. More recently, Congressman Jones of Oklahoma proposed that the states be preempted from taxing foreign source income. These limitations would apply to both residence and domiciliary states. They would prohibit a state from including in its tax base foreign source branch earnings, dividends, interest, royalties, rents, capital gains, or any other type of foreign source income paid to a U.S. corporation. Both specific allocation and apportionment of foreign source income would be prohibited.

Under the exemption approach, a taxpayer would pay the higher of the foreign or Federal tax liability on its foreign source income. This would have the effect of enabling some taxpayers to pay less total tax on their foreign source income than on their domestic source income. If the foreign tax was less than the Federal tax, the exemption would require a taxpayer to pay only as much as the Federal rate on his foreign source income; by contrast any domestic source income would be subject to the combined Federal and state rates.

State tax administrators criticize an exemption approach because the Federal source rules would be used to identify foreign source income. They argue that these rules ignore economic realities and can lead to tax avoidance practices. Sections 482 and 861 of the Internal Revenue Code are designed to deal with avoidance problems, but it is problematical whether similar weapons are available to state tax administrators. Presumably, state tax adminstrators would have to rely on the Internal Revenue Service to make most reallocations between domestic and foreign source income.

Statutory exemption of foreign income from State taxation would reduce state revenues by about $410 million, and would increase Federal revenues by about $200 million.

Table 1

State Corporate Taxes on or Measured by Net Income:
Type of Tax; Jurisdictional Basis; Tax Base; and Deductibility of Federal and Foreign Taxes

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
Alabama	Direct net income tax.	Doing business in state; deriving income from property or other sources within state.		X	Deductible	Gross up not taxed.
	Excise tax measured by net income.	Doing business in state as a banking institution.		X	Deductible	Gross up not taxed.
Alaska	Direct net income tax.	No jurisdictional tests in statute.	X		Nondeductible	Nondeductible
	License fee based on net income.	Engaging in business in state	X		Nondeductible	Nondeductible
Arizona	Direct net income tax.	No jurisdictional tests in statute.		X	Deductible	Gross up not taxed.
Arkansas	Direct net income tax.	Doing business in state.		X	Nondeductible	Deductible
California	Excise tax measured by net income.	Doing business in state.		X	Nondeductible	Gross up not taxed.
	Direct tax on net income not included in excise tax base.	Receipt of income from sources within state.		X	Nondeductible	Gross up not taxed.

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base: Federal base modified	Calculation of tax base: State defined base	Income taxes paid or accrued: Federal	Income taxes paid or accrued: Foreign
Colorado	Direct net income tax.	Doing business in state.	X		Nondeductible	Nondeductible
Connecticut	Excise tax measured by net income and capital and surplus.	Carrying on business in the state.	X		Nondeductible	Gross up not taxed.
Delaware	Direct net income tax.	No jurisdictional tests in statute.	X		Nondeductible	Foreign source dividends, royalties, interest not taxed, thus taxes on these items not in base.
District of Columbia	Excise tax measured by net income.	Carrying on or engaging in any trade or business within the District; receiving income from sources within the District.		X	Nondeductible	Gross up not taxed.
Florida	Excise tax measured by net income	Conducting business; deriving income from within state.	X		Nondeductible	Foreign source income not taxed, thus foreign taxes are not in tax base.
Georgia	Direct net income tax.	Owning property; doing business in state.	X		Nondeductible	Foreign source dividends not taxed, thus gross up not taxed.
Hawaii	Direct net income tax.	Owning property; carrying on trade or business in state.	X		Nondeductible	Nondeductible
	Excise tax measured by net income.	Doing a banking business within state.	X		Deductible to extent paid on Hawaii source income.	Nondeductible

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
Idaho	Excise tax measured by net income.	Qualifying to do business or doing business in state.	X		Nondeductible	Gross up not taxed.
	Direct tax on income not included in excise tax base.	Deriving income from sources within the state.	X		Nondeductible	Gross up not taxed.
Illinois	"Privilege" tax measured by net income; actually a direct net income tax.	Earning or receiving income in state.	X		Nondeductible	Gross up not taxed.
Indiana	Direct tax on adjusted gross income; supplemental net income tax.	No jurisdictional tests in statute.	X		Nondeductible	Nondeductible
Iowa	Direct net income tax.	Doing business in state	X		Deductible to extent of 50 percent of amount alloca-ble to Iowa.	Nondeductible
	Excise tax measured by net income.	Having principal office in state or authorized to conduct business in state.	X		Deductible to extent of 50 percent of amount alloca-ble to Iowa.	Nondeductible
Kansas	Direct income tax.	Doing business in state; deriving income from sources within state.	X		Nondeductible	Nondeductible
	Excise tax measured by net income.	Located or doing business within state.	X		Nondeductible	Nondeductible

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
Kentucky	Direct net income tax.	Having commercial domicile in state; owning or leasing property located in state; having person(s) receiving compensation in state.	X		Nondeductible	All dividends exempt, thus gross up not taxed.
Louisiana	Direct net income tax.	No jurisdictional tests in statute.		X	Deductible to extent paid on Louisiana income.	Gross up not taxed, others deductible to extent Louisiana tax paid on the income.
Maine	Direct net income tax.	Receipt of income allocable or apportionable to state	X		Nondeductible	Gross up not taxed.
	Excise tax measured by net income.	Location in state; doing business in state.	X		Nondeductible	Gross up not taxed.
Maryland	Direct net income tax.	Carrying on business within the state.	X		Nondeductible	All dividends exempt, thus foreign taxes on foreign source dividends not in base.
	Excise tax measured by net earnings.	Transacting business within the state.	X		Nondeductible	All dividends exempt, thus foreign taxes on foreign source dividends not in base.

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base: Federal base modified	Calculation of tax base: State defined base	Income taxes paid or accrued: Federal	Income taxes paid or accrued: Foreign
Massachusetts	Excise tax measured by net income.	Carrying on or doing business within the state.	X		Nondeductible	Because of deduction for intercorporate dividends, most of gross up not taxed.
	Direct tax on net income not included in excise tax base.	Deriving income from business carried on within the state.	X		Nondeductible	Because of deduction of intercorporate dividends, most of gross up not taxed.
Michigan	Value added tax.			X	Nondeductible	All dividends exempt thus foreign taxes on foreign source dividends not in base.
Minnesota	Excise tax measured by net income.	Doing business within state.		X	Nondeductible	Gross up not taxed.
	Direct tax on net income not included in excise tax base.	Ownership of property in state; doing business in interstate or foreign commerce within state.		X	Nondeductible	Gross up not taxed.
Mississippi	Direct net income tax.	Deriving income from property owned or sold and from business, trade carried on in state.		X	Nondeductible	Gross up not taxed.
Missouri	Direct net income tax.	Being required to file a Federal income tax return and having income of $100 or more from Missouri sources.	X		Deductible	All dividends exempt, thus foreign taxes on foreign source dividends not in base.

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
Missouri (cont'd)	Excise tax measured by net income.	Engaging in loan business within state.		X	Deductible	All dividends exempt, thus foreign taxes on foreign source dividends not in base.
Montana	Excise tax measured by net income.	Doing business in state.	X		Nondeductible	Nondeductible
	Direct tax on net income not included in excise tax base.	Receipt of income allocable to state by formula apportionment.	X		Nondeductible	Nondeductible
Nebraska	Excise tax measured by net income.	Doing business in state or exercising franchise in state.	X		Nondeductible	Nondeductible
	Direct tax on net income not included in excise tax base.	Doing business within state consisting exclusively of foreign or interstate commerce, or both.	X		Nondeductible	Nondeductible
Nevada	No tax on corporation net income.	------	--------------------		-----	-------

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
New Hampshire	Direct tax on gross business profits	Deriving economic benefit from the employment of property and/or labor within state.	X		Nondeductible	Gross up not taxed.
New Jersey	Excise tax measured by net income.	Exercise of corporate franchise within state; doing business, employing or owning capital or property, maintaining an office in state.	X		Nondeductible	Because of deduction for intercorporate dividends, most of gross up not taxed.
New Mexico	Direct net income tax.	Engaged in the transaction of business in the state; deriving income from property or employment within state.	X		Nondeductible	Nondeductible
	Excise tax measured by net income.	Located in state.	X		Nondeductible	Nondeductible
New York	Excise tax measured by the greater of net income or capital	Doing business, employing capital; owning or leasing property in state in a corporate or organized capacity; maintaining an office in state.	X		Nondeductible	Gross up not taxed.
North Carolina	Direct net income tax.	Doing business in state.	X		Nondeductible	Because of deduction for intercorporate dividends, most of gross up not taxed.
	Excise tax measured by net income tax	Maintaining one or more places of business in state.	X		Nondeductible	Because of deduction for intercorporate dividends, most of gross not taxed.

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
North Dakota	Direct net income tax.	Receipt of income from sources within state.	X		Deductible to extent of apportioned income.	Nondeductible
	Excise tax measured by net income	Doing business in state; location in state; having principal place of business in state.	X		Deductible	Nondeductible
Ohio	Excise tax measured by the greater of net income or the value of outstanding stock.	Doing business in state; owning or using part or all of its capital or property in state; holding a certificate of compliance authorizing it to do business in state.	X (if income measured used)		Nondeductible	Gross up not taxed.
Oklahoma	Direct net income tax.	Doing business in state; deriving income from sources within state.	X		Nondeductible	Nondeductible
	Excise tax measured by net income.	Located or doing business within state.	X		Nondeductible	Nondeductible
Oregon	Excise tax measured by net income.	Engaged in performing or maintaining any business or service or in selling any commodity within state.		X	Nondeductible	Taxes paid to foreign countries on dividends, interest, or royalties arising from foreign sources are deductible.
	Direct tax on net income not included in excise tax base.	Receipt of income allocable to state by formula apportionment, whether or not doing business within state.		X	Nondeductible	Taxes paid to foreign countries on dividends, interest, or royalties arising from foreign sources are deductible.

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
Pennsylvania	Excise tax measured by net income.	Doing business in state; using or employing property or capital in state.	X		Nondeductible	All dividends exempt, thus foreign taxes on foreign source dividends not in tax base.
Rhode Island	Direct tax on net income or net worth.	Deriving income from sources within state.	X (if income measure used)		Nondeductible	Nondeductible
				X (If net worth measure used)	Nondeductible	Nondeductible
	Excise tax measured by net income or capital stock.	Business location within state.		X	Deductible	Nondeductible
South Carolina	Direct net income tax.	Transacting, conducting, doing business or having an income within state.		X	Nondeductible	Gross up not taxed.
	Excise tax measured by net income	Location or doing business in state.		X	Deductible	Gross up not taxed.

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
South Dakota	Excise tax measured by net income. (Financial institutions only; other corporations not subject to a tax measured by net income.	Doing business within state.		X	Deductible	Deductible
Tennessee	Excise tax measured by net income.	Doing business within state in corporate form.	X		Nondeductible	Because of deduction for intercorporate dividends, most of gross up not taxed.
Texas	No tax on corporation net income	--------	-----	-----	-----	--------
Utah	Excise tax measured by net income.	Doing business within state.		X	Deductible	Deductible
	Direct tax on net income not included in excise tax base.	Receipt of income assignable to state by formula apportionment, whether or not doing business in state.		X	Deductible	Deductible

State	Type of tax	Statutory rules for defining jurisdiction to tax out-of-state corporations	Calculation of tax base		Income taxes paid or accrued	
			Federal base modified	State defined base	Federal	Foreign
Vermont	Direct net income tax.	No jurisdictional tests in statute.	X		Nondeductible	Gross up not taxed.
	Excise tax measured by net income.	Doing business within state.	X		Nondeductible	Gross up not taxed.
Virginia	Direct net income tax.	Receipt of Virginia source income.	X		Nondeductible	Gross up not taxed.
Washington	No tax on corporation net income.	----	----	----	-----	-----
West Virginia	Direct net income tax.	Engaging in business in state or deriving income from property, activity, or other sources within state.	X		Nondeductible	All dividends exempt, thus foreign tax on foreign source dividends not in base.
Wisconsin	Excise tax measured by net income.	Doing business within state.	X		Nondeductible	Gross up not taxed.
	Direct tax on net income not included in excise tax base.	Owning property located within state; doing business in interstate or foreign commerce within state.	X		Nondeductible	Gross up not taxed.
Wyoming	No tax on corporation net income.	------	----	---	-----	-----

Sources: "State Corporation Income Taxes and Other 'Doing Business Taxes': Tabular Summary of Statutory Provisions Affecting Multistate Business," State and Local 'Doing Business' Taxes on Out-of-State Financial Depositories, by the Advisory Commission on Intergovernmental Relations for the Committee on Banking, Housing, and Urban Affairs, United States Senate, May 1975, pp. 769-894; "Compilation of the Manner in which States Impose Income Taxes on Income from Foreign Sources," Committee on State Taxation, Council of State Chambers of Commerce, March 5, 1976; and State Tax Reporter, Commerce Clearing House, Inc., individual state volumes.

Table 2

Multistate Division of Base Provisions for Corporation Taxes on Net Income or Measured by Net Income with Emphasis on Special Foreign Source Income Rules

State	Dividends Received Deduction 1/	Dividends: Allocated 2/	Dividends: Apportioned 3/	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules 4/
Alabama	No	Allocated to commercial domicile for corporations chartered outside Alabama.	Apportioned if receiving corporation chartered in Alabama.	On accounts receivable, apportioned; portfolio interest allocated if payee has commercial domicile in state.	On trade or business property, apportioned; on real and tangible personal property, allocated if situs in state; on intangible personal property, allocated if owner's commercial domicile in state.	Apportioned if business income; allocated, if non-business income, on basis of situs 9/ extent of use of property in state, or payee's commercial domicile. 10/	From real property, allocated if situs in state; from personal property, allocated on the basis of extent of use in state or payee's commercial domicile. 11/	Gross up not taxed. 5/
Alaska	Yes		All dividends apportioned. Statute permits combination; 6/ has applied it on audit.	All interest received deemed taxable as business income and apportioned.	Allocated if situs of property in state; otherwise apportioned.	Allocated if situs of property in state; otherwise apportioned.	Allocated if situs of property in state; otherwise apportioned.	Dividend received deduction for dividends from domestic corporations. 7/
Arizona	No	Taxable unless received from corporation subject to Arizona income tax, allocated to commercial domicile.		Allocated to commercial domicile.	On trade or business property, apportioned; on other property, allocated if situs of property in state.	From real property, allocated if situs in state; others allocated to commercial domicile of taxpayer.	Allocated if taxpayer's commercial domicile in state.	Gross up not taxed. 5/
Arkansas	No	Dividends from at least 95 percent owned subsidiaries exempt.	Apportioned except for those from 95 percent owned subsidiaries.	Apportioned	Apportioned	Apportioned	Apportioned	Exemption applies to dividends from domestic and foreign subsidiaries. 8/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
California	No	Nonbusiness and nonunitary dividends allocated to commercial domicile.	State applies unitary worldwide combination; 6/ dividends from a nonunitary corporation apportioned if business income.	On accounts receivable and similar business accounts, apportioned; on long term investments, allocated to commercial domicile.	On trade or business property apportioned; on real and tangible personal property allocated if situs in state; on intangible personal property, allocated if owner's commercial domicile in state.	From plant and other business assets, apportioned; from nonbusiness assets, allocated on basis of situs,9/ extent of use of property in state, or commercial domicile.10/	From license to produce product produced by taxpayer, apportioned as business income; from real property, allocated if situs in state; from personal property, allocated on the basis of extent of use in state or payee's commercial domicile. 11/	Gross up not taxed.5/ Foreign (non U.S.) corporation that is part of unitary group is included in the apportionment.
Colorado	Yes		Nearly always apportioned as business income.	Nearly always apportioned as business income.	Nearly always apportioned as business income.	Nearly always apportioned as business income.	Nearly always apportioned as business income.	Dividends received deduction for dividends from domestic corporations. 7/
Connecticut	Yes	Dividends allocated to state if principal place of payee's business in state; but dividends from a majority owned subsidiary allocated to extent of subsidiary's business in state.	Combined 6/ return allowed at option of taxpayer or may be required to correct non-arm's length dealing.	On accounts receivable and other assets an integral part of the business activity, apportioned; nonbusiness interest allocated to state if principal place of business in state; interest from a majority owned subsidiary allocated to extent of subsidiary's business in state.	On real and tangible personal property, allocated if situs at sale in state; from intangible property, allocated if owner's principal place of business in state; however, if derived as an integral part of taxpayer's business, apportioned as business income.	From tangible personal and real property, allocated if situs in state; from intangible personal property, allocated if principal place of business in state.	Treated as business income and apportioned.	Gross up not taxed;5/ dividend received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Delaware	Yes	Dividends from a non-Delaware corporation for which a foreign tax credit is provided are exempt.	Remaining dividends apportioned.	Interest for which a foreign tax credit is provided is exempt; otherwise allocated to state where the transaction took place which resulted in creation of the debt, e.g. interest from debt marketed in N.Y. and held by the taxpayer's N.Y. bank would not be allocated to Delaware.	On real property or tangible property, allocated if situs or use in state; on intangibles, apportioned.	Allocated if situs of property in state.	Royalties for which a foreign tax credit is provided are exempt; others allocated if property generating royalty located or used in state.	Dividends from a non-Delaware corporation, interest, and royalties for which a foreign tax credit is provided are exempt.
District of Columbia	No	Allocated if nonbusiness income and from sources within the District.	Apportioned if business income.	Allocated if nonbusiness income from sources within the District; apportioned if business income.	On real property and tangible personalty, allocated to situs if nonbusiness income; on intangibles, allocated to commercial domicile if nonbusiness income; if business income, apportioned.	On real property and tangible personalty, allocated on basis of situs or extent of use if nonbusiness income; if business income apportioned.	Same as rents.	Gross up not taxed. 5/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Florida	Yes		Dividends from foreign sources exempt, remaining taxable dividends apportioned.	Foreign source interest exempt, remaining interest apportioned.	Same as interest.	Same as interest.	Same as interest.	Foreign source income is not taxable in any manner.
Georgia	Yes	Dividends from foreign sources exempt; remaining taxable dividends allocated to payee's principal place of business.		On accounts receivable and other assets connected to the business, apportioned; investment income, allocated to payee's corporate domicile or to situs of property generating the income.	On trade or business property and short term investments, apportioned; on other investment assets, allocated to situs of property or to payee's principal place of business.	If part of the taxpayer's normal business activities, apportioned; if investment or nonbusiness income, allocated to the location of the property or the taxpayer's principal place of business.	Same as rents.	Foreign source dividends not taxable.
Hawaii	No	85% of dividends from 95% owned subsidiaries not taxed; dividends from corporations having 15% of business in state not taxed; remaining taxable nonbusiness dividends allocated to payee's commercial domicile.	Remaining taxable dividends that are an integral part of the taxpayer's business are apportioned.	On business assets, apportioned; nonbusiness interest, allocated to payee's commercial domicile.	On trade or business property, apportioned; on real and tangible personal property, allocated if situs in state; on intangible personalty, allocated if commercial domicile in state.	From plant and other business assets, apportioned; from real property, allocated if situs in state; from tangible personalty, allocated on basis of extent of use in state of payee's commercial domicile. 10/	Same as rents and royalties on intangibles allocated on basis of extent of use or payee's commercial domicile. 11/	Dividend deduction applies to dividends from domestic and foreign subsidiaries. 8/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Idaho	No	Dividends from corporation deriving 50% or more of its income from Idaho are 85% excluded from tax base.	Remaining taxable dividends apportioned. State may allow, at taxpayer's request, or require, to accurately reflect income, the filing of a combined 6/ return.	Law presumes interest is apportionable, but state court recently held interest on portfolio investments is allocable to payee's commercial domicile.	Law presumes gains apportionable, but state court recently held gains allocable to situs or payee's commercial domicile, if not taxable in situs state.	Apportioned if business income; allocated if nonbusiness income, on basis of situs, 9/ extent of use of property in state, or payee's commercial domicile. 10/	Same as gains. 9/11/	Gross up not taxed; 5/ dividends received deduction applies to some domestic, but no foreign source dividends.
Illinois	Yes	Remaining taxable dividends from corporations in which taxpayer has less than 50 percent ownership interest are allocated if payee's commercial domicile in state.	Remaining taxable dividends from corporation in which taxpayer has at least 50% ownership interest are apportioned.	Apportioned if business income; allocated to commercial domicile if nonbusiness income.	On trade or business property, apportioned as business income; on other assets, if nonbusiness income, allocated to situs of property if real or tangible personal property; to commercial domicile if intangible personalty or taxpayer not taxable where personal property had situs.	If from an integral part of the taxpayer's business activities, apportioned as business income; if nonbusiness income, allocated to situs if real property, to extent of use or commercial domicile if tangible personal property. 10/	Same as rents and royalties on intangibles allocated on basis of extent of use or payee's commercial domicile. 11/	Gross up not taxed; 5/ dividend received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Indiana	Yes	Most dividends, other than when dealing in securities is a principal business acitivity of the taxpayer, are allocated to recipient's commercial domicile.	Apportioned as business income if securities dealing a principal activity of the taxpayer.	On accounts receivable and from securities activities that are a principal business activity of the taxpayer, apportioned; remaining interest is nonbusiness income and is allocated to payee's commercial domicile.	Apportioned as business income if acquisition, management, and disposition of property constitutes an integral part of the taxpayer's regular business operation; otherwise allocated to situs of property.	Apportioned as business income if rental of property is a principal business activity of the taxpayer; otherwise allocated on basis of situs, 9/ extent of use of property, or payee's commercial domicile. 10/	Allocated as nonbusiness income to payee's commercial domicile if from patents which are incidental to a taxpayer's regular trade or business operations and licensing does not represent a principal business activity; otherwise apportioned as business income.	Dividends received deduction for dividends from domestic corporations. 7/
Iowa	Yes	Taxable dividends are allocated to payee's commercial domicile, but in proportion to the payer corporation's income that is attributable to Iowa.		Same as dividends.	On real property, allocated to situs; on tangible personalty, allocated to situs or commercial domicile; on intangible personalty, allocated to commercial domicile.	From real property, allocated to situs; from tangible personalty, allocated on basis of extent of use in state or payee's commercial domicile. 10/	If nonbusiness income, allocated to commercial domicile; if business income, apportioned.	Dividends received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Kansas	Yes	Dividends allocated to payee's commercial domicile.		On accounts receivable, apportioned as business income; portfolio and other nonbusiness interest allocated to commercial domicile.	On business property, apportioned as business income; other gains are nonbusiness income allocated to situs or commercial domicile. 12/	If received from regular business property, apportioned as business income; others allocated on basis of situs, 9/ extent of use of property in state, or payee's commercial domicile. 10/	If generated by use in a like business, apportioned as business income; others allocated on the basis of situs, 9/ extent of use, or commercial domicile. 11/	Dividends received deduction for dividends from domestic corporations. 7/
Kentucky	No	All dividends exempt.		On accounts receivable, apportioned as business income; on other assets, allocated as nonbusiness income to commercial domicile.	On sale of machinery or other business property, apportioned as business income; on real property, allocated to situs; on tangible personalty, allocated to situs of property or taxpayer's commercial domicile; 12/ on intangible personalty, allocated to commercial domicile.	If part of the normal business, such as the rental of excess manufacturing space, apportioned as business income; nonbusiness rents from real property such as from an investment property, allocated to situs; nonbusiness rents from personalty, allocated to extent of use or commercial domicile. 10/	If from patents used as integral part of payee's business, apportioned as business income; if nonbusiness income, allocated to extent of use in state or to commercial domicile. 11/	All dividends, whether domestic or foreign source, exempt. 8/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Louisiana	No	Allocated to commercial domicile unless shares have a business situs elsewhere; however, if paid by at least a 50% owned subsidiary out of income earned outside the state, allocated elsewhere.		On accounts receivable, allocated to situs of payer; other interest allocated to business situs of debt instrument or commercial domicile of payee.	From real and tangible personalty, allocated to situs of asset; from intangibles, allocated to business situs of asset or commercial domicile of payee.	Allocated to situs of property.	From real and tangible personalty, allocated to situs of property; on intangibles, allocated to state of use.	Gross up not taxed. 5/
Maine	Yes	If nonbusiness income, allocated to state if payee's commercial domicile in state.	If business income, apportioned.	On accounts and notes receivable, apportioned; nonbusiness interest allocated to commercial domicile.	Apportioned if business income; gains from nonbusiness real property allocated to situs; gains from nonbusiness tangible personalty allocated to situs or owner's commercial domicile; 12/ gains from nonbusiness intangible personalty allocated to owner's commercial domicile.	Apportioned if business income; from nonbusiness real property, allocated to situs; from nonbusiness personalty, allocated on basis of extent of use in state or payee's commercial domicile. 10/	Apportioned if business income; if nonbusiness income, allocated same as rents and royalties on intangibles allocated on basis of extent of use or payee's commercial domicile. 11/	Gross up not taxed; 5/ dividends received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Maryland	No	Dividends exempt from tax.		On accounts receivable and installment contracts, apportioned as business income; investment interest is nontaxable.	From real property, allocated to situs; from tangible personalty, allocated to situs or owner's commercial domicile; 12/ from intangible personalty, allocated to commercial domicile.	Allocated to situs of property.	Patent and copyright royalties apportioned as business income if reasonably attributed to the business; from real and tangible personalty, allocated to situs.	All dividends, whether domestic or foreign, exempt. 8/
Massachusetts	No	All dividends exempt except: from Massachusetts corporate trusts; from non-wholly owned DISCs, and if less than 15% of payer's stock owned.	Remaining dividends apportioned as business income.	Apportioned	Apportioned	Apportioned	Apportioned	Most dividends, domestic and foreign source, exempt. 8/
Michigan	SEE TEXT							
Minnesota	No	Allocated to payee's commercial domicile, but an 85% dividends received deduction allowed.		From property employed in business and from idle cash, apportioned; remaining interest allocated to commercial domicile.	From tangible property, allocated to situs; from intangibles, allocated to legal or commercial domicile; however, apportioned if business income.	Allocated to situs, but apportioned if business income.	From real and tangible personal property not used in business, allocated to situs; from patents not use in business, allocated to legal or commercial domicile; from property used in business, apportioned.	Gross up not taxed; 5/ 85% dividends received deduction for dividends from domestic and foreign corporations. 8/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Mississippi	No	Allocated to commercial or actual situs		Allocated to commercial or actual situs.	On trade or business property, apportioned; otherwise allocated to situs.	Allocated to situs.	Allocated to commercial or actual situs.	Gross up not taxed. 5/
Missouri	No	Intercorporate dividends exempt.		If taxpayer elects statutory one factor sales formula, apportioned, if taxpayer elects three factor formula, apportioned if business income and allocated to commercial domicile if nonbusiness income.	Same as interest except gains on real property allocated to situs, on tangible personalty allocated to situs, or commercial domicile, 12/ and on intangibles allocated to commercial domicile.	Same as interest except allocated on basis of situs, 9/ extent of use of property in state, or payee's commercial domicile. 10/	Same as interest except allocated on basis of situs situs, 9/ extent of use, or commercial domicile. 11/	All intercorporate dividends, whether domestic or foreign source, exempt. 8/
Montana	Yes		Taxable dividends are apportioned; statute permits combination; 6/ state has applied it, but matter is pending in court.	Apportioned	Apportioned except Montana transactions allocated.	Apportioned except Montana rents allocated.	Apportioned except Montana transactions allocated.	Dividends received deduction for dividends from domestic corporations. 7/
Nebraska	Yes	Clearly nonbusiness dividends allocated to commercial domicile.	Taxable dividends are generally apportioned. Regulations provide that state may permit or require the filing of a combined return 6/ to property reflect income, but worldwide combination is not presently used.	Usually apportioned except clearly nonbusiness interest is allocated to commercial domicile.	Usually apportioned except clearly nonbusiness gains are allocated to situs (real property and tangible personalty) or commercial domicile (intangible personalty).	Usually apportioned except clearly nonbusiness rents allocated on basis of situs, 9/ extent of use of property in state, or payee's commercial domicile. 10/	Same as rents except royalties on intangibles allocated on basis of extent of use or payee's commercial domicile. 11/	Dividends received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Nevada	NO TAX ON CORPORATE NET INCOME							
New Hampshire	No		Dividends from subsidiary subject to N.H. tax and from at least 30% controlled foreign subsidiary exempt. Gross up not taxed. Remaining taxable dividends apportioned.	Interest from subsidiary subject to N.H. tax and from at least 30% controlled foreign subsidiary exempt. Remaining interest apportioned.	Apportioned	Apportioned	Apportioned	Gross up not taxed; 5/ dividends and interest from at least 30% controlled foreign affiliate exempt.
New Jersey	No		Dividends from at least 80% owned affiliate, whether foreign or domestic, exempt; 50% of dividends from other affiliates exempt; remaining taxable dividends apportioned.	Apportioned	Apportioned	Apportioned	Apportioned	Most of the gross up not taxed; 5/ intercorporate dividend deduction applies uniformly to dividends from foreign and domestic corporations. 8/
New Mexico	Yes	Taxable portfolio dividends allocated to commercial domicile.	Taxable subsidiary dividends apportioned.	On accounts receivable and short term securities, apportioned; long term investment interest allocated to commercial domicile.	On trade on business property, if nonbusiness from real property allocated to situs, from tangible personalty, to situs or commercial domicile, 12/ and from intangibles to commercial domicile.	Business rents apportioned; nonbusiness rents allocated to situs, 9/ or extent of use or commercial domicile. 10/	Most royalties apportioned; clearly nonbusiness royalties allocated on basis of situs, 9/ extent of use, or commercial domicile. 11/	Dividends received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
New York	No		Dividends from more than 50% owned subsidiaries, whether domestic or foreign, exempt; 50% of other dividends also exempt with the remaining 50% apportioned to N.Y. on the basis of the payer's N.Y. business. Combined 6/ reporting selectively applied at discretion of tax commission to correctly reflect income.	Interest from more than 50% owned subsidiary, whether domestic or foreign, exempt; all other interest apportioned to N.Y. on basis of the payer's N.Y business.	From real property and tangible personalty, apportioned via a three factor formula; gains on securities of more than 50% owned subsidiaries exempt.	Apportioned	Apportioned	Gross up not taxed; 5/ dividends, interest, and gains, from at least 50% owned subsidiaries, domestic and foreign, are exempt. 8/
North Carolina	No	Dividends from controlled affiliates exempt if parent corporation has a North Carolina commercial domicile; portion of dividends on which the paying corporation has been subject to N.C. tax is exempt; taxable dividends allocated to state of commercial domicile.		If the purpose of acquiring the intangible generating the interest is directly related to the taxpayer's business activity, interest is considered business income and is apportioned; nonbusiness interest is allocated to commercial domicile	Gains are apportioned as business income if the assets, while owned by the taxpayer, produced business income. Nonbusiness gains from real property allocated to situs; from tangible personalty allocated to situs or commercial domicile; 12/ from intangible personalty allocated to commercial domicile.	Apportioned if business income. Nonbusiness rents from real property allocated to situs; from tangible personalty allocated in relation to extent of use or commercial domicile if taxpayer not taxable where property is utilized.	Apportioned as business income if the patent or copyright was created or used as an integral part of the taxpayer's principal business activity. Nonbusiness royalties from real and tangible personalty allocated same as rents; from intangibles allocated in relation to extent of use or to commercial domicile. 11/	Dividend deduction applies to dividends from domestic and foreign corporations. 8/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
North Dakota	No	ALL INCOME, WITH RARE EXCEPTIONS, IS APPORTIONED						None
Ohio	Yes 13/		Taxable dividends limited to: domestic source dividends less the Federal dividend received deduction; foreign source non-subsidiary dividends less any gross up of federal dividend received credit. Thus, dividends from a foreign subsidiary are exempt. Taxable dividends approtioned in proportion to payer's Ohio situs property. Thus, few, non-subsidiary foreign source dividends would be apportioned to Ohio.	Apportioned	From real property, allocated to situs; from tangible personalty allocated to situs; from dividend producing stock, allocated in relation to issuing corporation's Ohio situs property, from remaining intangibles, allocated to commercial domicile.	From real property, allocated to situs; from tangible personalty allocated in relation to extent of use in Ohio.	Foreign source royalties exempt. From real property, allocated to situs; from tangible personaltv allocated in relation to extent of use in Ohio; from patents and coyrights, allocated to the extent the activity of the payer generating the royalty occurs in Ohio.	Gross up, 5/ subpart F income, foreign source royalties, and foreign source dividends from subsidiaries are not taxable. Thus, only taxable foreign source income is: branch income and passive income other than royalties and excluded dividends.
Oklahoma	Yes	Allocated to taxpayer's commercial domicile.		Apportioned if unitary business income; otherwise allocated to commercial domicile.	On real and tangible personalty, allocated to situs; on intangibles, allocated to commercial domicile.	Allocated to situs	Same as gains.	Dividends received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Oregon	No	Nonbusiness dividends allocated to commercial domicile.	Dividends from a subsidiary taxable in Oregon are exempt. Dividends that are business income are apportioned. Worldwide combination 6/ is freely used.	Apportioned if business income; allocated to commercial domicile if nonbusiness income.	If from an asset used in the taxpayer's trade or business, gain is apportioned as business income. Nonbusiness gains allocated to state of situs 9/ or commercial domicile. 12/, 14/	Apportioned if business income. Nonbusiness rents from real property allocated to situs; from tangible personalty allocated in relation to extent of use in state or to taxpayer's commercial domicile. 10/	Apportioned if business income. Nonbusiness royalties from tangible personalty allocated same as rents; from intangibles, allocated in relation to extent of use in state or to payee's commercial domicile. 11/	Worldwide combination freely used; taxes on foreign nonbusiness and nonunitary income are deductible.
Pennsylvania	No	All dividends domestic and foreign are exempt.		Apportioned	Apportioned	Apportioned	Apportioned	All dividends, domestic and foreign source, exempt. 8/
Rhode Island	Yes	-------------------GENERALLY, ALL INCOME TREATED AS BUSINESS INCOME AND APPORTIONED.--------------------						
South Carolina	No	From at least 80% owned subsidiaries, exempt; other dividends allocated to payee's principal place of business.		If business income, for example from certificates of deposit and commercial securities, apportioned; nonbusiness interest allocated to principal place of business.	On real property, allocated to situs; on tangible personalty allocated to situs or principal place of business; 12/ on intangibles, allocated to principal place of business	Apportioned if business income; otherwise allocated to situs.	If from property that is used in or connected with the business of the taxpayer, apportioned; nonbusiness royalties from real property allocated to situs; patent and copyright royalties allocated to state to extent of use or to principal place of business. 11/	Gross up not taxed; 5/ dividends from at least 80% owned subsidiaries, domestic and foreign, exempt. 8/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
South Dakota	--NO TAX ON CORPORATE NET INCOME--							
Tennessee	No	From at least 80% owned subsidiaries, exempt; other dividends allocated to commercial domicile.		Allocated to commercial domicile.	On real property, allocated to situs, on tangible personalty allocated to situs or commercial domicile. 12/	From real property, allocated to situs; from tangible personalty, to extent of use in state or to commercial domicile. 10/	From real property and tangible personalty same as rents; patent and copyright royalties allocated to extent of use in State or to commercial domicile. 11/	Dividends from at least 80% owned subsidiaries, domestic and foreign, exempt. 8/
Texas	--NO TAX ON CORPORATE NET INCOME --							
Utah	No	Dividends that are clearly nonbusiness are allocated to commercial domicile.	Most dividends are apportioned.	On accounts receivable, tax obligation accounts, legally mandated accounts, invested working capital, apportioned; clearly investment interest allocated to commercial domicile.	On trade or business property, apportioned; nonbusiness gains from real property allocated to situs; from tangible personalty, to situs or commercial domicile. 12/	Apportioned if business income, nonbusiness rents from real property allocated to situs; from tangible personalty, allocated to extent of use or to commercial domicile. 10/	Apportioned if business income; nonbusiness royalties from real property allocated to situs; from tangible and intangible personalty, same as rents. 11/	Foreign taxes on nonbusiness income deductible.
Vermont	Yes		Taxable dividends are apportioned.	Apportioned	Apportioned	Apportioned	Apportioned	Gross up not taxed; 5/ dividends received deduction for dividends from domestic corporations. 7/

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Virginia	Yes	Non-subsidiary dividends allocated to recipient's principal place of business.	Dividends from majority owned subsidiaries are apportioned; dividends exempt if at least 50% of the paying corporation's income was subject to Virginia income tax.	Interest from majority owned subsidiaries is apportioned; other interest allocated to principal place of business.	From sale of a subsidiary's stock, apportioned; from real property, allocated to situs; from tangible personalty, allocated to situs or principal place of business; 12/ from intangibles, allocated to principal place of business.	From real property, allocated to situs; from intangible personalty, allocated in relation to extent of use in state or to principal place of business. 10/	From real property, allocated to situs; from personal property, allocated on basis of extent of use or commercial domicile. 11/	Gross up not taxed; 5/ dividends received deduction for dividends from domestic corporations. 7/
Washington	---NO TAX ON CORPORATE NET INCOME---							
West Virginia	No	All dividends exempt.		Apportioned if business income; nonbusiness interest allocated to commercial domicile.	Apportioned	Apportioned if business income; nonbusiness rents from real property, allocated to situs; from tangible personalty, allocated in relation to extent of use or to commercial domicile. 10/	Apportioned if business income; nonbusiness royalites from real property allocated to situs; nonbusiness royalties from tangible and intangible personalty allocated in relation to extent of use or to commercial domicile. 11/	All dividends, whether domestic or foreign, exempt.

State	Dividends Received Deduction	Dividends: Allocated	Dividends: Apportioned	Interest	Capital Gains	Rents	Royalties	Special Foreign Rules
Wisconsin	No	Dividends from corporations with at least 50% of their income taxable in Wisconsin are exempt.	Taxable dividends apportioned.	Apportioned	From real property and tangible personalty, allocated to situs.	From real property or tangible personalty allocated to situs.	From real property and tangible personalty, allocated to situs; from intangibles, allocated to commercial domicile.	Gross up not taxed. 5/
Wyoming	NO TAX ON CORPORATE NET INCOME							

Footnotes

1/ This column refers specifically to the deduction for intercorporate dividends provided by the Federal Internal Revenue Code. "Yes " indicates the state allows the Federal deduction, "No" indicates it does not. Several states provide their own intercorporate dividend deduction. These deductions are described in the "dividends" column.

2/ Allocation means the attribution of an income item to a specific geographic source. It involves the attribution of particularly categories of income wholly within or wholly without the taxing state. Dividends, for example, may be allocated to the taxing state provided the payee's commercial domicile is in the state. If it is not, the dividends would be allocated outside that state, but may, of course, be taxable in another state. Allocation is usually used as an adjunct to formula apportionment.

3/ Apportionment refers to a method for dividing the tax base among states in which the share to be assigned a particular taxing state is determined by reference to one or more ratios in which economic values or activities within the state are compared with the taxpayer's total activities or values of the same kind everywhere.

4/ This column describes any special rules for the treatment of foreign source income.

5/ Under the Internal Revenue Code, dividends from a foreign corporation are increased or grossed up by the amount of foreign taxes deemed paid with respect to the underlying corporate tax for which a foreign tax credit is claimed. By removing this gross up from its tax base a state in effect, allows a deduction for those foreign taxes.

6/ Combination refers to the unitary system whereby formula apportionment is applied to a controlled corporate group, rather than a single corporate taxpayer.

7/ Under the Internal Revenue Code, a U.S. corporation can deduct 85 percent of dividends from other U.S. corporations and 100 percent of dividends received from U.S. corporations in which there is an 80 percent or more ownership. Dividends from foreign corporations are deductible only if the foreign corporation has at least 50 percent of its gross income effectively connected with a U.S. trade or business. Because of this limitation, it seems appropriate to describe the Federal dividends received deduction as applying mainly to dividends from domestic corporations.

8/ This, like similar provisions in other states, is not a special rule; it applies equally to domestic and foreign subsidiaries. However, it is noted to contrast it with the Federal dividend received deduction, available mainly to dividends from domestic corporations.

9/ Applies to real property.

10/ Applies to tangible personal property. Rents are only allocated to commercial domicile if the taxpayer is not taxable in the state where the property is used.

11/ Only allocated to commercial domicile if the recipient of the royalty is not taxable where the property is used.

12/ Applies to tangible personal property. Capital gains only allocated to commercial domicile if the taxpayer is not taxable at the situs of property.

13/ Only as provided by section 243 (applies to domestic corporations) of the Code.

14/ Capital gains on intangibles allocated to payee's commercial domicile.

Sources: "State Corporation Income Taxes and Other 'Doing Business Taxes': Tabular Summary of Statutory provisions Affecting Multistate Business," State and Local "Doing Business" Taxes on Out-of-State Financial Depositories, by the Advisory Commission in Intergovernmental Relations for the Committee on Banking, Housing, and Urban Affairs, United States Senate, May 1975; pp. 769-894; Compliation of the Manner in which States Impose Income Taxes on Income from Foreign Sources," Committee on State Taxation, Council of State Chambers of Commerce, March 5, 1976; and State Tax Reporter, Commerce Clearing House, Inc., individual state volumes.

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FOR IMMEDIATE RELEASE January 19, 1977

U.S.A. AND ITALY TO NEGOTIATE REVISED INCOME TAX TREATY

The Treasury Department today announced that representatives of the United States and Italy will meet in Rome during the week of February 14, 1977 to renegotiate the income tax treaty between the two countries.

The existing income tax treaty was signed in 1955 and has been in effect since 1956. During the past 20 years, many tax treaty concepts have been modified, particularly as a result of the work of the Fiscal Committee of the Organization for Economic Cooperation and Development (OECD). Consequently, the 1955 U.S.A.-Italy treaty is now outmoded in a number of respects. Moreover, the extensive changes in Italian income tax law, effective in January 1974, raised doubts about the continued applicability of the treaty, which has continued in effect under the terms of an interim agreement negotiated in December 1974 pending renegotiation of the treaty.

The new treaty will be based on the draft U.S.A. model income tax treaty published by the Treasury Department on May 18, 1976 it will also take into account the OECD Model Draft as well as other recent treaties concluded by the United States and Italy.

Interested persons are invited to submit comments in writing by February 11, 1977 to the Assistant Secretary for Tax Policy, U.S. Treasury, Room 3108, Washington, D.C. 20220.

This announcement appears in the Federal Register of January 21, 1977.

# # # #

WS-1271

The proposed changes in the regulations regarding combination sales will not apply to insurance provided under binding arrangements entered into before November 5, 1976, if no new employees are added after the date the notice of proposed rule making is filed with the *Federal Register*.

A notice of the proposed regulations will appear in the *Federal Register* at an early date.

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Chron

REMARKS BY THE HONORABLE WILLIAM E. SIMON
SECRETARY OF THE TREASURY
AT THE
SECURITIES AND EXCHANGE COMMISSION CONFERENCE
WASHINGTON, D. C.
JANUARY 13, 1977

NEAR-TERM ISSUES AND LONG-TERM PERSPECTIVES

ONE WEEK FROM NOW EIGHT YEARS OF REPUBLICAN PRESIDENTIAL LEADERSHIP WILL END AND A NEW DEMOCRATIC ADMINISTRATION WILL ASSUME CONTROL. AS WE SHIFT OUR ATTENTION AWAY FROM THE RECENT ELECTION THE NATION WILL STILL CONFRONT THE PERSISTENT PROBLEMS THAT HAVE PLAGUED POLICY MAKERS FOR AT LEAST TWO DECADES. THE CLAIMS AND PROMISES MADE DURING THE ELECTION WILL NOW BE TESTED AGAINST THE HARSH REALITIES OF THE REAL WORLD AND THE RISING EXPECTATIONS OF THE PEOPLE WILL BE MATCHED AGAINST THE BASIC CAPACITY OF ~~THE~~ our SYSTEM TO DELIVER.

ALL OF US CLEARLY SHARE AN INTEREST IN THE SUCCESS OF THE NEXT ADMINISTRATION. WHETHER WE CALL OURSELVES REPUBLICANS, DEMOCRATS, OR INDEPENDENTS; FIRST AND FOREMOST WE ARE AMERICANS INTERESTED IN THE PROGRESS OF OUR GREAT NATION. THAT IS THE SPIRIT IN WHICH PRESIDENT FORD HAS APPROACHED THE TRANSITION, AND BECAUSE PRESIDENT-ELECT CARTER HAS BEEN AS GRACIOUS IN VICTORY AS PRESIDENT FORD HAS BEEN GENEROUS IN DEFEAT, WE ARE EXPERIENCING ONE OF THE MOST HARMONIOUS TRANSFERS OF POWER IN OUR NATION'S HISTORY. IT IS A TRIBUTE BOTH TO THE PEOPLE INVOLVED AND TO OUR DEMOCRATIC INSTITUTIONS THAT IT HAS PROCEEDED SO SMOOTHLY. FOR MY PART, I HAVE BEEN IMPRESSED BY THE QUALITY OF APPOINTMENTS TO THE MAJOR POSITIONS OF ECONOMIC LEADERSHIP AND WE HAVE ALL WELCOMED THE CAREFUL APPROACH ADOPTED BY THE INCOMING ADMINISTRATION AS IT ESTABLISHES ITS GOALS AND POLICIES IN A MANNER NECESSARY TO SUSTAIN AND STRENGTHEN CONSUMER AND BUSINESS CONFIDENCE. I PARTICULARLY

WISH MY SUCCESSOR, MIKE BLUMENTHAL, WELL AS HE ASSUMES THE LEADERSHIP OF THE DEPARTMENT OF THE TREASURY WITH ITS MANY COMPLEX DOMESTIC AND INTERNATIONAL RESPONSIBILITIES.

AS THE TRANSITION COMES TO AN END IT IS IMPORTANT TO NOTE THE BASIC STRENGTH AND BALANCE OF THE CURRENT U.S. ECONOMY. WHILE MONTHLY STATISTICS ALWAYS FOLLOW A CONFUSING COURSE THE UNDERLYING POSITION IS CLEAR: WE ARE NOW APPROACHING THE SECOND ANNIVERSARY OF A HEALTHY EXPANSION IN ~~THE~~ our ECONOMY AND THE PROSPECTS FOR SUSTAINING THAT GROWTH ARE BETTER THAN THEY HAVE BEEN AT ANY TIME IN OVER A DECADE. CONSUMER SPENDING CONTINUES TO GROW AS PERSONAL INCOMES RISE PROVIDING REAL PURCHASING POWER NOW THAT THE RATE OF INFLATION HAS BEEN MORE THAN HALVED. WITH THE IMPORTANT AUTOMOBILE INDUSTRY BACK ON TRACK WIDESPREAD CONSUMPTION GAINS WILL CONTINUE AND BUSINESS INVENTORY BUYING WILL MOVE AHEAD

CAREFULLY. HOUSING CONSTRUCTION HAS IMPROVED SHARPLY AND THE IMPRESSIVE STARTS OF RECENT MONTHS WILL SOON BE REQUIRING THE purchase of CONSUMER DURABLE GOODS that most AMERICANS NOW TAKE FOR GRANTED. BUSINESS SPENDING FOR NEW EQUIPMENT IS ALREADY STRONG AND THERE ARE SIGNALS THAT THE SLUGGISH PACE OF NEW PLANT CONSTRUCTION WILL ACCELERATE. CURRENT REPORTS INDICATE THAT GOVERNMENT SPENDING IS ONCE AGAIN ON THE PROJECTED TRACK. INTERNATIONAL ECONOMIC RELATIONS CONTINUE TO BE POSITIVE AS TRADE AND INVESTMENT CONTINUED TO GROW THIS PAST YEAR DESPITE THE SEVERE DISRUPTIONS CAUSED BY THE SHARP INCREASES IN OIL PRICES AND OCCASIONAL PROTECTIONIST ACTIONS BY A FEW NATIONS. THE MAJOR CURRENT DISAPPOINTMENT, OF COURSE, IS THE UNSATISFACTORY UNEMPLOYMENT RATE BUT EVEN HERE THERE CAN BE SOME SATISFACTION IN THE EXTRAORDINARY GAINS IN EMPLOYMENT--Nearly 3 MILLION NEW JOB HOLDERS--IN 1976 THAT PUSHED EMPLOYMENT TO RECORD LEVELS AND THE SPECIFIC IMPROVEMENTS IN HOURS WORKED, OVERTIME HOURS, as well as THE REDUCTION IN LAYOFFS ~~AND THE RETURN OF REAL INCOME GAINS.~~ WHILE SOME CRITICS TEND TO DOWNGRADE THIS RESTORATION OF A HEALTHY AND BALANCED ECONOMIC EXPANSION, MARKED BY SIGNIFICANTLY LOWER RATES OF INFLATION AND EXTRAORDINARY GROWTH IN THE LABOR FORCE, THE ACTUAL RECORD IS CLEAR FOR ALL WHO ARE WILLING TO ANALYZE THE TANGIBLE STATISTICS OF PROGRESS.

HOWEVER, AS THE NEW ADMINISTRATION DEVELOPS ITS POLICIES TO DEAL WITH THE CONSTANTLY CHANGING NEAR-TERM ISSUES, ITS REAL TEST WILL COME IN HOW WELL ITS LEADERS MAINTAIN THEIR LONG-TERM PERSPECTIVES. THIS IS A REAL RATHER THAN A RHETORICAL CHALLENGE. FOR EXAMPLE, DURING THE LAST FIFTEEN YEARS THE <u>REAL</u> OUTPUT OF GOODS AND SERVICES HAS INCREASED 60 PERCENT, THE REAL INCOME OF THE AVERAGE AMERICAN HAS RISEN BY 50 PERCENT, AND THE PERCENTAGE OF ALL AMERICANS LIVING IN POVERTY, AT LEAST AS STATISTICIANS DEFINE IT, HAS BEEN CUT IN HALF. BUT DESPITE THESE REMARKABLE GAINS THE AMERICAN PEOPLE ARE INCREASINGLY

DISSATISFIED WITH THE NATIONAL STATE OF AFFAIRS AND THEIR PERSONAL STATUS. I believe that PART OF THIS FRUSTRATION IS A HEALTHY REFUSAL TO TOLERATE THE MANY REAL PROBLEMS THAT PERSIST. THE AMERICAN DRIVE TO IMPROVE, TO HELP THOSE LESS FORTUNATE, AND TO SEEK EVER-HIGHER PERSONAL STANDARDS OF LIVING IS COMMENDABLE WHEN IT LEADS TO A MORE CREATIVE AND PRODUCTIVE SYSTEM AND INCREASED CONCERN FOR THE NEEDS OF OTHERS. BUT THERE IS ALSO AN UNHEALTHY ASPECT IN MUCH OF THE CYNICISM AND NEGATIVISM THAT WE FIND IN AMERICA TODAY. I BELIEVE THIS MORE UGLY MOOD IS THE RESULT OF THE DEMONSTRATED FAILURE OF COLLECTIVIST BIG-GOVERNMENT APPRO~~A~~CHES TO NATIONAL PROBLEMS ✓ THAT PROMISED SO MUCH BUT DELIVERED MUCH LESS. IN THE PROCESS, A MOOD OF DEPENDENCE ON GOVERNMENT HAS INCREASED WHICH FEEDS UPON ITSELF CREATING STILL MORE DEMANDS FOR BENEFITS WITHOUT RECOGNIZING THAT THE BILLS MUST BE PAID--EITHER DIRECTLY IN CURRENT TAXES OR INDIRECTLY THROUGH ACCELERATING INFLATION AND ECONOMIC DISRUPTION.

ALTHOUGH THE RESPONSIBILITY AND AUTHORITY FOR DEVELOPING THE NECESSARY POLICIES FOR DEALING WITH NEAR-TERM ISSUES NOW RESTS WITH THE NEW ADMINISTRATION, ALL OF US HAVE A RIGHT TO VOICE OUR OPINIONS ABOUT WHAT THE NATION'S ECONOMIC GOALS AND POLICIES SHOULD BE DURING THE NEXT FEW YEARS. AS A PROSPECTIVE PRIVATE CITIZEN, I SUGGEST THE FOLLOWING LONG-TERM PERSPECTIVES BE USED WHILE DETERMINING CURRENT POLICIES.

FIRST, THE DIVERSITY OF PROBLEMS MUST BE RECOGNIZED TO AVOID CONCENTRATING ON A SINGLE ISSUE. IN THE MID-1960'S THE UNITED STATES BEGAN AN UNFORTUNATE SERIES OF ECONOMIC BOOMS AND RECESSIONS: SERIOUS OVERHEATING OF THE ENTIRE ECONOMY CREATED SEVERE PRICE PRESSURES; ACCELERATING INFLATION CAUSED RECESSIONS BY RESTRICTING HOUSING CONSTRUCTION, PERSONAL SPENDING, AND BUSINESS INVESTMENT; THE RECESSIONS CAUSED UNWANTED UNEMPLOYMENT WHICH WASTED RESOURCES AND CAUSED PERSONAL SUFFERING; RISING UNEMPLOYMENT TOO OFTEN TRIGGERED POORLY PLANNED AND ILL-TIMED GOVERNMENT FISCAL AND MONETARY

POLICIES, SETTING OFF ANOTHER ROUND OF EXCESSIVE STIMULUS LEADING ONCE AGAIN TO OVERHEATING--INFLATION--RECESSION--UNEMPLOYMENT--AND EVEN MORE GOVERNMENT INTERVENTION. INFLATION, UNEMPLOYMENT, DECLINING OUTPUT, THE AVAILABILITY OF PRODUCTIVE RESOURCES, AND INTERNATIONAL TRADE AND INVESTMENT ALL MUST BE CONSIDERED SIMULTANEOUSLY TO CREATE A BALANCED PROGRAM FOR STABLE ECONOMIC GROWTH.

SECOND, GOVERNMENT POLICY INITIATIVES MUST SOLVE MORE PROBLEMS THAN THEY CREATE. DURING A PERIOD OF DIFFICULTY IT IS EXPEDIENT TO RESPOND TO STRIDENT CALLS "TO DO SOMETHING--ANYTHING TO DEMONSTRATE POLITICAL LEADERSHIP." BUT THIS NAIVELY ACTIVIST APPROACH IS TOO OFTEN THE BASIC SOURCE OF PROBLEMS NOT THE SOLUTION. COURAGE AND WISDOM ARE ALWAYS REQUIRED TO AVOID ACTIONS OFFERING THE ILLUSION OF SHORT-TERM BENEFITS IN EXCHANGE FOR LONGER-TERM PROBLEMS. FOR EXAMPLE, THE FINE-TUNING APPROACH OF CONSTANTLY SHIFTING THE GOVERNMENT'S FISCAL AND

MONETARY POLICIES THAT IS APPARENTLY FAVORED BY MANY PROFESSIONAL ECONOMISTS AND POLITICIANS HAS PROVEN TO BE COUNTER-PRODUCTIVE DURING THE LAST DECADE BECAUSE THE LAGGED IMPACT OF THESE WELL-INTENTIONED POLICY ACTIONS HAS REPEATEDLY EXAGGERATED THE PERIODS OF ECONOMIC BOOM AND CONTRACTION. BUT THE LONGER-TERM DISRUPTIONS ARE EVEN MORE SERIOUS AS THE SPENDING INITIATIVES CREATED TO SOLVE CURRENT CRISES CONTINUE TO GROW LONG AFTER THE INITIAL NEED HAS ENDED CREATING EVEN MORE MOMENTUM FOR THE FEDERAL BUDGET, WHICH HAS BECOME LARGELY UNCONTROLLABLE, AND continuous MASSIVE DEFICITS. SIMILARLY, PERIODS OF EXCESSIVE CREDIT EXPANSION ARE TYPICALLY FOLLOWED BY ACCELERATING INFLATION RESULTING EVENTUALLY IN SHARP CONTRACTIONS OF THE MONEY SUPPLY LEADING TO PERIODIC CREDIT CRUNCHES. THE CONVENTIONAL WISDOM THAT A FEW BILLION DOLLARS OF ADDITIONAL GOVERNMENT SPENDING OR JUST A LITTLE FASTER GROWTH IN THE MONETARY AGGREGATES--ASSUMING THAT YOU CAN IDENTIFY THE RIGHT

ONE--SOMEHOW MAKES THE DIFFERENCE BETWEEN SUCCESS OR FAILURE OF THE ENTIRE U.S. ECONOMY, WHICH IS RAPIDLY APPROACHING AN ANNUAL LEVEL OF OUTPUT OF TWO TRILLION DOLLARS, HAS ALWAYS AMAZED ME.

Now we all agree THERE IS AN IMPORTANT ROLE FOR GOVERNMENTS IN PROTECTING CERTAIN BASIC PUBLIC INTERESTS BUT THE CLAIM THAT GOVERNMENTS CAN OR SHOULD CONTROL THE ECONOMY IS TOTALLY FALSE. THERE MUST BE MORE WIDESPREAD RECOGNITION OF THE FUNDAMENTAL IMPORTANCE OF STABLE ECONOMIC GROWTH IN THE FUTURE AS THE ONLY TRUE FOUNDATION FOR MAXIMUM EMPLOYMENT OPPORTUNITIES AND LOWER UNEMPLOYMENT RATES; FOR MORE MODERATE RATES OF INFLATION WHICH WILL PROTECT THE PURCHASING POWER OF ALL AMERICANS AND ENCOURAGE MORE CAPITAL INVESTMENT NEEDED TO PROVIDE THE PERMANENT AND PRODUCTIVE JOBS THAT PEOPLE DESIRE; FOR MORE EFFICIENT USE OF HUMAN AND MATERIAL RESOURCES AND PROTECTION OF THE ENVIRONMENT; AND FOR FULFILLMENT OF OUR INTERNATIONAL RESPONSIBILITIES IN MONETARY, TRADE, AND INVESTMENT relationships.

~~RELATIONSHIPS~~. THERE WILL NATURALLY BE STRONG DISAGREEMENTS ABOUT HOW BEST TO ACHIEVE THESE BASIC GOALS BUT I AM CONVINCED THAT A LONGER-TERM TIME HORIZON MUST BE USED.

IN LOOKING TO THE FUTURE THE AMERICAN PEOPLE SHOULD ASK A BASIC QUESTION EACH TIME THEIR GOVERNMENT COMES UP WITH A NEW POLICY INITIATIVE: WILL THIS ACTION CONTRIBUTE TO SUSTAINED AND ORDERLY GROWTH OR WILL IT MERELY PERPETUATE THE FAMILIAR STOP-AND-GO PATTERNS OF THE PAST LEADING TO INCREASED GOVERNMENT SPENDING WITHOUT REGARD FOR THE CHRONIC DEFICITS AND ECONOMIC AND FINANCIAL DISRUPTION CREATED, EXCESSIVE EXPANSION OF THE MONEY SUPPLY, and EVEN MORE GOVERNMENT CONTROLS OVER THE PRIVATE ECONOMY, ~~AND~~ as well as INCREASED INTERVENTION IN PRIVATE WAGE AND PRICE DECISIONS.

THIRD, OUR BASIC DESIRE FOR ~~ECONOMIC~~ PROGRESS, THROUGH IMPROVED LIVING STANDARDS AND INCREASED EMPLOYMENT OPPORTUNITIES

WILL BE FRUSTRATED UNLESS WE BETTER CONTROL THE INSIDIOUS INFLATION WHICH HAS DISRUPTED OUR ECONOMIC STABILITY AND which ULTIMATELY will THREATEN~~S~~ ALL OF OUR BASIC INSTITUTIONS. WHEN INFLATION DISTORTS THE ECONOMIC SYSTEM AND ERODES THE INCENTIVES FOR REAL IMPROVEMENT THE PEOPLE WILL NO LONGER SUPPORT THAT SYSTEM AND SOCIETY DISINTEGRATES. I AM CONVINCED THAT OUR UNIQUELY CREATIVE AND PRODUCTIVE SOCIETY WILL NOT SURVIVE IF INFLATION DOMINATES ECONOMIC AFFAIRS. THERE IS NO TRADEOFF BETWEEN THE GOALS OF PRICE STABILITY AND LOW UNEMPLOYMENT. TO THE CONTRARY, THE ACHIEVEMENT OF BOTH GOALS IS INTERDEPENDENT. IF WE ARE TO CONTINUE TO INCREASE THE OUTPUT OF GOODS AND SERVICES AND SIGNIFICANTLY REDUCE UNEMPLOYMENT, WE MUST MAKE FARTHER PROGRESS IN REDUCING INFLATION TO CREATE MORE STABILITY AND INVESTMENT INCENTIVES. AT THE SAME TIME INCREASED INVESTMENT, HIGHER EMPLOYMENT, AND IMPROVED PRODUCTIVITY WILL ALL CONTRIBUTE DIRECTLY TO THE MODERATION OF INFLATION.

FOURTH, THERE MUST BE A PROPER BALANCE IN THE SHARED RESPONSIBILITIES OF THE PRIVATE AND PUBLIC SECTORS. THIS IS A DIFFICULT ASSIGNMENT BECAUSE OF THE CONFUSTION AND PESSIMISTIC APPRAISALS OF THE FUTURE CAUSED BY THE POLITICAL AND ECONOMIC SHOCKS THAT HAVE OCCURRED. MAINTAINING AND IMPROVING THE CREATIVITY AND PRODUCTIVITY OF THE U.S. ECONOMIC SYSTEM AGAINST THE ATTACKS OF CRITICS WHO FAVOR A BIG-GOVERNMENT SOLUTION FOR THE PROBLEMS OF SOCIETY HAS BECOME A MAJOR CHALLENGE. THE SIMPLISITC CURE OF HAVING GOVERNMENT SPEND EVER INCREASING AMOUNTS OF BORROWED MONEY HAS NOT SOLVED MANY OF OUR PROBLEMS BUT IT HAS CREATED SERIOUS ECONOMIC DISTORTIONS THAT WILL CONTINUE LONG INTO THE FUTURE. WE NOW HAVE A FEDERAL GOVERNMENT THAT IS TRYING TO DO MORE THAN ITS RESOURCES WILL 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 OF THESE THINGS AT THE SAME TIME. NEVERTHELESS, MUCH OF THE CURRENT POLITICAL RHETORIC

CONTINUES TO CLAIM THAT WE AREN'T SPENDING ENOUGH, AREN'T CREATING ENOUGH NEW GOVERNMENT PROGRAMS, AND AREN'T PUSHING ENOUGH PANIC BUTTONS. DESPITE THE UNMATCHED ACCOMPLISHMENTS OF THE U.S. ECONOMY THESE CRITICS ATTACK THE FREE ENTERPRISE SYSTEM AND DEMAND COMPREHENSIVE GOVERNMENTAL CONTROL OVER ECONOMIC PLANNING FOR THE ALLOCATION OF OUR NATIONAL RESOURCES--THE RATIONING OF CAPITAL TO SELECTED INDUSTRIES--GUARANTEED GOVERNMENT JOBS FOR ALL WHO WANT THEM--INCREASED CONTROL OVER PRIVATE ECONOMIC ACTIVITIES--EVEN A RETURN TO THE COUNTER-PRODUCTIVE WAGE AND PRICE CONTROLS THAT HAVE ALWAYS FAILED. ALTHOUGH THE AMERICAN FREE ENTERPRISE SYSTEM FEEDS, CLOTHES AND HOUSES OUR PEOPLE MORE EFFECTIVELY THAN ANY OTHER SYSTEM IN THE WORLD, PROVIDES THE REAL BASIS FOR ALL OF OUR PUBLIC SERVICES AND MOST IMPORTANTLY IS FUNDAMENTAL TO OUR INDIVIDUAL FREEDOMS, IT IS INCREASINGLY SUBJECT TO CRITICISM FROM THOSE WHO SEEM TO FAVOR TURNING TO LESS EFFICIENT APPROACHES WHICH

WOULD WASTE OUR HUMAN AND MATERIAL RESOURCES AND EVENTUALLY ERODE OUR ECONOMIC PROGRESS AND POLITICAL FREEDOMS.

PART OF THE PROBLEM IS A MATTER OF IMAGE. THOSE WHO SUPPORT INCREASED GOVERNMENT SPENDING AND PERVASIVE CONTROLS OVER OUR DAILY LIVES ARE OFTEN PERCEIVED AS BEING MORE CONCERNED AND SOCIALLY PROGRESSIVE. THOSE WHO ALLEGEDLY "CARE MORE" ARE GIVEN CONSIDERABLE ATTENTION WHEN THEY CALL FOR MORE SPENDING TO SOLVE THE UNMET NEEDS OF SOCIETY EVEN THOUGH THE GROWTH OF BIG GOVERNMENT HAS BECOME A LARGE PART OF THE PROBLEM AND NOT THE SOLUTION IT IS ALLEGED TO BE. AT THE SAME TIME, THOSE WHO FAVOR THE FREE ENTERPRISE SYSTEM TOO OFTEN CONVERSE IN SIMPLISTIC SLOGANS THAT LACK HUMANE APPEAL. WORST OF ALL, MANY BUSINESSMEN WHO COME TO WASHINGTON SEEM TO WANT TO SURRENDER THEIR EXISTING FREEDOMS IN EXCHANGE FOR PROTECTION FROM THE COMPETITION THAT HAS MADE OUR SYSTEM SO DYNAMIC.

IT IS NOW TIME--IN FACT THE NEED IS LONG OVERDUE--FOR THOSE WHO BELIEVE IN THE FREE ENTERPRISE SYSTEM TO MORE EFFECTIVELY PROMOTE ITS BASIC VALUES. AMERICA HAS BECOME THE WORLD'S PREMIER ECONOMY BECAUSE IT PROVIDES BASIC INCENTIVES TO ITS PEOPLE TO WORK HARD AND TO BE CREATIVE. TO THE INDIVIDUAL FAMILY THIS APPROACH LEADS TO A HIGHER STANDARD OF LIVING. TO THE BUSINESS FIRM IT MEANS INCREASED MARKETS AND LARGER PROFITS. TO OUR GOVERNMENT IT MEANS INCREASED EFFECTIVENESS AND PUBLIC SUPPORT.

IN SHORT, TOO MANY AMERICANS--ESPECIALLY THOSE WHO HAVE KNOWN ONLY THE AFFLUENT SOCIETY--ARE UNAWARE OF THE REAL SOURCE OF ECONOMIC GROWTH IN OUR COUNTRY. THE MATERIAL ABUNDANCE, THE FREEDOMS OF CHOICE, THE OPPORTUNITIES FOR MEANINGFUL WORK ARE ALL LARGELY THE RESULT OF THE CREATIVITY AND PRODUCTIVITY OF OUR FREE AND COMPETITIVE ECONOMIC SYSTEM.

THIS IS THE CRUCIAL THEME THAT MUST BE COMMUNICATED TO ALL AMERICANS UNTIL THEY UNDERSTAND IT. THE AMERICAN ECONOMY IS THE WELL SPRING OF OUR NATION'S BASIC STRENGTH IN EVERY SPHERE--POLITICAL, SOCIAL, MILITARY AND ECONOMIC. IT IS THE SOURCE OF OUR PRESENT ABUNDANCE AND THE BASIS OF OUR HOPES FOR A BETTER FUTURE. WE CAN SOLVE OUR RECOGNIZED PROBLEMS BEST BY PRESERVING AND IMPROVING AND STRENGTHENING RATHER THAN WEAKENING OUR UNIQUELY PRODUCTIVE SYSTEM. AND IN DOING THIS WE WILL PRESERVE OUR OTHER FREEDOMS THAT HAVE MADE AMERICA SO GREAT.

THE UNITED STATES NOW FACES A BASIC CHOICE. YET WE HEAR MISLEADING POLITICAL RHETORIC THAT WE CAN ACHIEVE OUR BASIC ECONOMIC GOALS WITHOUT MAKING THE NECESSARY SACRIFICES REQUIRED TO PRODUCE AND PAY FOR THE DESIRED GOODS AND SERVICES. OUR MAGNIFICENT COUNTRY IS CAPABLE OF ACHIEVING ANY WORTHY GOAL IT IDENTIFIES BUT WE MUST FACE UP TO MANY

ECONOMIC REALITIES, PARTICULARLY THE OBVIOUS POINT THAT GOODS AND SERVICES CANNOT BE DISTRIBUTED TO THE CONSUMING PUBLIC UNLESS THEY ARE FIRST PRODUCED. WE HAVE THE HUMAN AND MATERIAL RESOURCES NECESSARY TO OPERATE OUR OPEN AND COMPETITIVE ECONOMIC SYSTEM TO ACHIEVE OUR GOALS IF WE WILL CREATE THE PROPER ENVIRONMENT. HOW WELL WE MAKE THESE BASIC DECISIONS WILL ULTIMATELY DETERMINE THE LONG-TERM DEVELOPMENT OF AMERICA.

But TO FIND THE ANSWERS WE MUST BEGIN WITH THE CORRECT QUESTIONS. WHAT HAS MADE THIS A GREAT NATION? WHAT HAS MADE PEOPLE THROUGHOUT THE WORLD TALK ABOUT THE AMERICAN DREAM?

HAS IT BEEN THE LAND AND OUR NATURAL RESOURCES? WE HAVE CERTAINLY BEEN BLESSED WITH AN ABUNDANCE OF RESOURCES. BUT IN THE SOVIET UNION WE SEE A LAND MASS THAT IS MUCH LARGER THAN OUR OWN AND ONE WHICH IS EQUALLY WELL-ENDOWED. YET, THE SOVIET SYSTEM PROVIDES MUCH LESS FOR THE PEOPLE. THEY MUST TURN TO THE UNITED STATES FOR THE GRAIN THEY NEED TO FEED THEIR OWN PEOPLE AND FOR OUR TECHNOLOGY AND CAPITAL.

DOES OUR STRENGTH DEPEND ONLY ON THE QUALITIES OF OUR PEOPLE? WE ARE CLEARLY BLESSED WITH ONE OF THE LARGEST AND MOST TALENTED POPULATIONS THAT THE WORLD HAS EVER KNOWN. BUT IN CHINA TODAY WE SEE A POPULATION THAT IS FOUR TIMES AS LARGE AS OUR OWN, WHOSE CIVILIZATION AT ONE TIME WAS DEVELOPED FAR IN ADVANCE OF THE REST OF THE WORLD. YET THEIR PRESENT MATERIAL STANDARD OF LIVING AND PERSONAL FREEDOMS ARE MOST DISAPPOINTING.

SO WHILE OUR LAND, RESOURCES AND PEOPLE HAVE BEEN ESSENTIAL PARTS OF THE AMERICAN STORY, THERE IS A THIRD FACTOR THAT IS TOO OFTEN MISSING IN OTHER COUNTRIES~~, THAT HAS CONTRIBUTED TO AMERICA'S PROGRESS~~. THAT CRUCIAL FACTOR HAS BEEN OUR NATIONAL COMMITMENT TO LIBERTY AND INDIVIDUAL DIGNITY.

FOR TWO HUNDRED YEARS PEOPLE HAVE STREAMED TO OUR SHORES IN SEARCH OF VARIOUS FREEDOMS--FREEDOM OF RELIGION, FREEDOM OF SPEECH, FREEDOM OF THE PRESS, FREEDOM OF ASSEMBLY,

AND FREEDOM TO SEEK THEIR FORTUNES WITHOUT FEAR OR FAVOR OF THE GOVERNMENT. ALL OF THESE FREEDOMS ARE PLANTED FIRMLY IN OUR CONSTITUTION. BUT THEY HAVE BECOME SUCH A FAMILIAR PART OF OUR LIVES THAT I WONDER WHETHER WE NOW TAKE THEM TOO MUCH FOR GRANTED.

THERE IS NOTHING ARTIFICIAL ABOUT FREEDOM, NOR IS THERE ANY GUARANTEE OF ITS PERMANENCY. AS DWIGHT EISENHOWER ONCE SAID, "FREEDOM HAS ITS LIFE IN THE HEARTS, THE ACTIONS, AND THE SPIRITS OF MEN, AND SO IT MUST BE DAILY EARNED AND REFRESHED--ELSE LIKE A FLOWER CUT FROM ITS LIFE-GIVING ROOTS, IT WILL WITHER AND DIE."

THERE ARE MANY WAYS THIS CAN HAPPEN, SOME OF THEM VERY SLOW AND SUBTLE. FOR EXAMPLE, THERE HAS BEEN AN ACCELERATING TREND TOWARD COLLECTIVIST POLICIES IN THE UNITED STATES AS PEOPLE HAVE BEEN PERSUADED THAT THE PROBLEMS OF OUR SOCIETY HAVE BECOME SO LARGE THAT INDIVIDUALS CAN NO LONGER COPE WITH

THEM. MANY AMERICANS NOW EXPECT THE GOVERNMENT TO ASSUME RESPONSIBILITY FOR SOLVING THEIR PROBLEMS AND TO DO THINGS FOR THEM THAT THEY ONCE DID FOR THEMSELVES. GOVERNMENT HAS BEEN GRADUALLY CAST INTO THE ROLE OF TRYING TO SOLVE ALL THE DIFFICULT CHALLENGES OF MODERN LIFE.

THAT TREND BEGAN TO ACCELERATE IN THE 1960'S AS GOVERNMENTS PROMISED THE RAPID SOLUTION OF COMPLEX POLITICAL, ECONOMIC AND SOCIAL PROBLEMS AND THE END OF ECONOMIC CYCLES BASED ON THE CLEVER MANIPULATION OF GOVERNMENT POLICIES. WE FAILED TO NOTE THAT RESOURCES ARE ALWAYS LIMITED, EVEN IN A NATION AS AFFLUENT AS OURS. UNFORTUNATELY, THE INFLATED EXPECTATIONS AND BROKEN PROMISES OF THE PAST HAVE LEFT A RESIDUE OF DISILLUSIONMENT. MANY YOUNG PEOPLE ARE SKEPTICAL ABOUT OUR BASIC INSTITUTIONS AND I CAN'T SAY THAT I BLAME THEM.

INTERNATIONAL PROBLEMS, THE ENERGY CRISIS, DISAPPOINTING HARVESTS, EXCESSIVE GOVERNMENT REGULATIONS, WAGE AND PRICE CONTROLS AND THOUSANDS OF OTHER SPECIFIC PROBLEMS HAVE CONTRIBUTED SIGNIFICANTLY TO THE UNSATISFACTORY LEVELS OF INFLATION AND UNEMPLOYMENT. BUT THE UNDERLYING MOMENTUM HAS BEEN BASICALLY CAUSED BY THE EXCESSIVE ECONOMIC STIMULUS PROVIDED BY THE FEDERAL GOVERNMENT FOR MORE THAN A DECADE. FOR EXAMPLE: Look @ the Record

-- A QUADRUPLING OF THE FEDERAL BUDGET IN JUST 15 YEARS;

-- A STRING OF 16 BUDGET DEFICITS IN 17 YEARS;

-- AND A DOUBLING OF THE NATIONAL DEBT IN JUST 10 YEARS.

THE GREATEST IRONY OF THESE MISGUIDED POLICIES IS THAT THEY WERE BASED ON THE MISTAKEN NOTION THAT THEY WOULD SPECIFICALLY HELP THE POOR, THE ELDERLY, THE SICK AND THE DISADVANTAGED. YET WHEN THESE STOP-AND-GO GOVERNMENT POLICIES

TRIGGER INFLATION AND UNEMPLOYMENT, WHO GETS HURT THE MOST? THE VERY SAME PEOPLE THE POLITICIANS CLAIMED THEY WERE TRYING TO HELP -- THE POOR, THE ELDERLY, THE SICK AND THE DISADVANTAGED.

EVEN MORE FUNDAMENTALLY, THE LAST FIFTEEN YEARS HAVE SEEN AN ACCELERATION OF THE TREND TOWARD BIG GOVERNMENT AND THE DIMINISHING OF ECONOMIC AND PERSONAL FREEDOMS IN THE UNITED STATES. THE FEDERAL GOVERNMENT HAS NOW BECOME THE DOMINANT FORCE IN OUR SOCIETY. IT IS THE BIGGEST SINGLE EMPLOYER, THE BIGGEST CONSUMER, AND THE BIGGEST BORROWER. FIFTY YEARS AGO, TOTAL GOVERNMENT SPENDING COMPRISED APPROXIMATELY 10 PERCENT OF THE GROSS NATIONAL PRODUCT; IN 1976 THAT FIGURE WILL EXCEED 35 PERCENT. IF THE GOVERNMENT SPENDING TRENDS OF THE LAST TWO DECADES CONTINUE, THE TOTAL GOVERNMENT SHARE OF ECONOMIC ACTIVITY IN THE UNITED STATES

WILL BE APPROACHING 60 PERCENT BY THE YEAR 2000. IF THE GOVERNMENT EXERCISES SUCH A DOMINATING INFLUENCE IN THE ECONOMY, IT WILL ALSO CONTROL MANY OF THE PERSONAL DECISIONS OF ITS CITIZENS. HISTORY SHOWS THAT WHEN ECONOMIC FREEDOM DISAPPEARS PERSONAL AND POLITICAL FREEDOMS ALSO DISAPPEAR. THE INEXTRICABLE RELATIONSHIP BETWEEN ECONOMIC FREEDOM AND PERSONAL FREEDOM IS SOMETIMES OVERLOOKED BY THOSE WHO CONSTANTLY SEEK TO EXPAND THE POWERS OF GOVERNMENT, BUT IT IS PLAIN TO SEE IN MANY COUNTRIES AROUND THE WORLD WHERE THESE FREEDOMS HAVE BEEN LOST.

UNFORTUNATELY, THERE IS NO CONVENIENT SCAPEGOAT TO BLAME OUR PROBLEMS ON. AS MODERN GOVERNMENTS HAVE USURPED THE POWER TO INCREASINGLY CONTROL OUR DAILY LIVES THEY HAVE DONE SO WITH GOOD INTENT THINKING THAT THEY ARE THE PROPER AUTHORITY TO DETERMINE AND THEN IMPLEMENT THE IDEALS OF SOCIETY.

IN THE PROCESS GOVERNMENTS HAVE SACRIFICED INDIVIDUAL FREEDOMS FOR A COLLECTIVE SYSTEM OF RULES NEEDED TO IMPOSE THEIR VIEW OF WHAT IS BEST FOR EACH OF US. BUT THIS BEHAVIOR IS MERELY A REFLECTION OF WHAT THEY BELIEVE THE PEOPLE WANT. THEY HAVE CREATED AN ENVIRONMENT IN WHICH EQUALITY OF STATUS IS MISTAKEN FOR EQUALITY OF OPPORTUNITY AND SECURITY, ALBEIT A FALSE SENSE OF WELL BEING, IS EXCHANGED FOR PERSONAL FREEDOM. AS A RESULT THERE IS AN INCREASING MOOD OF FRUSTRATION AS PUBLIC SKEPTICISM INCREASES ABOUT OUR ABILITY TO HANDLE THE PROBLEMS OF THE FUTURE. IF THIS TREND CONTINUES, MOST OF THE FREEDOMS THAT WE CHERISH WILL NOT SURVIVE BECAUSE PERSONAL -- POLITICAL -- AND ECONOMIC FREEDOMS ARE ALL INTERTWINED AND CANNOT EXIST ALONE. THE GREAT HISTORIAN GIBBON NOTED THIS TENDENCY IN WRITING AN EVALUATION OF ANCHIENT GREECE:

"IN THE END, MORE THAN THEY WANTED FREEDOM, THEY WANTED SECURITY. THEY WANTED A COMFORTABLE LIFE AND THEY LOST IT ALL -- SECURITY, COMFORT, AND FREEDOM. WHEN THE ATHENIANS FINALLY WANTED NOT TO GIVE TO SOCIETY BUT FOR SOCIETY TO GIVE TO THEM, WHEN THE FREEDOM THEY WISHED FOR MOST WAS FREEDOM FROM RESPONSIBILITY, THEN ATHENS CEASED TO BE FREE."

OUR BASIC CHALLENGE THEN IS TO DETERMINE HOW MUCH PERSONAL FREEDOM, IF ANY, THAT WE ARE WILLING TO GIVE UP IN SEEKING COLLECTIVIST SECURITY. IT IS CERTAINLY NOT EASY TO LIVE WITH THE UNCERTAINTIES THAT EXIST IN A FREE SOCIETY BUT THE REAL PERSONAL BENEFITS CREATED ARE FAR SUPERIOR TO ANY OTHER SYSTEM. IT IS THIS HERITAGE OF PERSONAL FREEDOM THAT HAS MADE AMERICA A LAND BLESSED ABOVE ALL OTHERS. TO PROTECT THIS REMARKABLE PRIVILEGE IS A GOAL WORTHY OF OUR GREATEST COMMITMENT.

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DATE: January 24, 1977

TREASURY BILL RATES

	13-WEEK	26-WEEK
LAST WEEK:	4.668%	4.868%
TODAY:	4.700%	4.905%
HIGHEST SINCE 11/15/76:	4.800%	5.018%
LOWEST SINCE ______:		

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE January 24, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,502 million of 13-week Treasury bills and for $3,603 million of 26-week Treasury bills, both series to be issued on January 27, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing April 28, 1977			26-week bills maturing July 28, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.817	4.680%	4.80%	97.527 a/	4.892%	5.09%
Low	98.810	4.708%	4.83%	97.516	4.913%	5.11%
Average	98.812	4.700%	4.82%	97.520	4.905%	5.10%

a/ Excepting 1 tender of $350,000

Tenders at the low price for the 13-week bills were allotted 92%.
Tenders at the low price for the 26-week bills were allotted 21%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 19,595,000	$ 14,435,000	$ 18,575.000	$ 3,575,000
New York	4,142,145,000	2,120,215,000	6,016,255,000	3,076,985,000
Philadelphia	26,080,000	23,950,000	78,115,000	33,965,000
Cleveland	33,790,000	30,400,000	32,300,000	8,200,000
Richmond	25,460,000	21,260,000	79,125,000	60,125,000
Atlanta	26,030,000	20,625,000	46,390,000	34,100,000
Chicago	265,280,000	118,235,000	376,265,000	172,265,000
St. Louis	44,800,000	23,535,000	33,610,000	11,235,000
Minneapolis	23,865,000	15,480,000	55,685,000	31,685,000
Kansas City	34,580,000	26,240,000	30,845,000	20,845,000
Dallas	23,185,000	20,105,000	29,490,000	13,490,000
San Francisco	282,800,000	67,215,000	466,270,000	136,270,000
Treasury	70,000	70,000	115,000	115,000
TOTALS	$4,947,680,000	$2,501,765,000 b/	$7,263,040,000	$3,602,855,000 c/

b/ Includes $ 317,460,000 noncompetitive tenders from the public.
c/ Includes $ 130,210,000 noncompetitive tenders from the public.
1/ Equivalent coupon-issue yield.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M.

January 25, 1977

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 $6,300 million, or thereabouts, to be issued February 3, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,600 million, or thereabouts, representing an additional amount of bills dated November 4, 1976, and to mature May 5, 1977 (CUSIP No. 912793 F9 2), originally issued in the amount of $3,710 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,700 million, or thereabouts, to be dated February 3, 1977, and to mature August 4, 1977 (CUSIP No. 912793 J4 9).

The bills will be issued for cash and in exchange for Treasury bills maturing February 3, 1977, outstanding in the amount of $6,303 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,785 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, January 31, 1977. 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 or at the Bureau of the Public Debt on February 3, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 3, 1977. 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, or from the Bureau of the Public Debt.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: L.F. Potts
Extension: 2951
January 25, 1977

FOR IMMEDIATE RELEASE

TREASURY DEPARTMENT ANNOUNCES
INITIATION OF ANTIDUMPING INVESTIGATIONS
WITH RESPECT TO INEDIBLE GELATIN AND ANIMAL GLUE FROM
YUGOSLAVIA, THE FEDERAL REPUBLIC OF GERMANY, SWEDEN,
AND THE NETHERLANDS

Acting Assistant Secretary of the Treasury John H. Harper announced today the initiation of antidumping investigations with respect to inedible gelatin and animal glue from Yugoslavia, the Federal Republic of Germany, Sweden, and the Netherlands. Notices of these four initiations will appear in the Federal Register of January 26, 1977.

Acting Assistant Secretary Harper's announcement followed a summary investigation conducted by the U.S. Customs Service after receipt of petitions alleging that dumping was occurring in the United States. The information received tends to indicate that there is injury to or likelihood of injury to or prevention of establishment of an industry in the United States.

Imports of the subject merchandise during the period January through September 1976 were as follows: the Netherlands, $964,000; Sweden, $506,000; West Germany, $655,000; and Yugoslavia, $590,000.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE January 25, 1977

SECRETARY BLUMENTHAL ADDRESSES TREASURY EMPLOYEES

Treasury Secretary W. Michael Blumenthal today addressed employees in the Office of the Secretary at Departmental headquarters in the Main Treasury building in Washington.

Mr. Blumenthal, who was sworn in as the 64th Secretary of the Treasury on Sunday at the White House, held a number of briefings for employees of the Office of the Secretary of the Treasury in the department's historic Cash Room.

He promised an open and accessible administration, one in which efficiency and public service would be highlighted. "It will be a hallmark of the Carter Administration to try to break out of the sometimes artifical isolation of Washington," he said.

Mr. Blumenthal said the mark of Treasury operations would be working with the staff "openly, closely and as informally as possible." He added that he wished to assure "efficiency and cost effectiveness in all Treasury operations." The Secretary said that improvements of this nature will "require a lot of analysis" and that his objectives "apply to all Treasury branches and bureaus."

Secretary Blumenthal told the senior Treasury staff that he expected the Department to be conducted with attention to "equal opportunity for all. I am especially interested in assuring that these principles are applied to the Department's training and development programs."

In seeking their help and guidance, the new Secretary pointed out, "Americans in government are in no way inherently less efficient that those who work in private industry. You are certainly no less capable of doing a good job and being proud of your work.

"So, I have no hesitation in defining the spirit in which we begin our work. We want to be efficient. We want to proceed pragmatically and with care. And we want to be truthful about our failures, as well as our successes.

"I want all of you to share in these goals and to feel that you are helping to accomplish them."

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Department of the TREASURY
WASHINGTON, D.C. 20220
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NEWS

For Release on Delivery

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE HOUSE BUDGET COMMITTEE
WASHINGTON, D.C., THURSDAY, JANUARY 27, 1977 10:00A.M.

Mr. Chairman and members of this distinguished Committee:

It is a pleasure to appear before you this morning. Although this is my first opportunity to appear before a committee of Congress since becoming Secretary of the Treasury, I expect that you and your colleagues will make a veteran of me in short order.

Mr. Schultze has indicated to you the reasons why we believe a stimulative package is needed for the economy at the present time and the impact the package will have on the economy.

Let me explain the strategy behind this stimulative program. First, this program has a 2-year time perspective -- the years 1977 and 1978. By the end of this period, we expect to be making significant progress toward achieving full employment and to be experiencing generally high rates of economic activity. Secondly, the program is designed to have a great degree of flexibility. As we continually monitor the improvement in the economy, we can either add additional stimulus or cut back as economic conditions warrant.

I will outline for you the tax aspects of this stimulative package and indicate what we believe will be the effect on the capital market of not only the tax features of the package but also of the entire stimulative program that we are presenting. I will also outline the impact the program will have on the international economy.

The tax features of the program have a two-fold purpose: to provide a quick injection of spending into the national economy and also to take the first step in a tax simplification and tax reform program.

In broad terms, stimulus to the economy will be provided by a payment of $50 per capita to almost everyone. This will be accomplished by a general refundable rebate of 1976 taxes of $50 for each taxpayer, spouse, child, and other dependent. In the case of individuals or of families who have either no dependents or no earned income, this rebate will not exceed the amount of 1976 tax liability. Also, a payment of $50 per beneficiary will be made to Social Security beneficiaries, those receiving supplemental security income payments (SSI), and those receiving Railroad Retirement payments.

The $50 per person rebate and Social Security payment will amount to about $11.4 billion. The payments will be made this Spring in the months of April, May, and June. The total rebate payments, therefore, should fall entirely in fiscal year 1977.

The second tax feature in the program is a tax simplification measure designed to substantially simplify the tax laws for those presently using the standard deduction. I will describe the tax simplification aspects of this proposal subsequently. Let me say at the present this involves enlarging the standard deduction for joint returns with incomes of $17,500 or less and single returns with incomes of $15,000 or less. This is accomplished by substituting a flat deduction of $2,400 for single people, and $2,800 for married couples, for the present complex set of standard deduction provisions.

This increase in the standard deduction will apply for the entire calendar year 1977 as well as subsequent years. However, this tax reduction cannot be reflected in lower withholding until approximately a month after the date of the enactment of the bill. We are assuming that the required withholding changes can become effective as of the first of May. Since the lower withholding will not be in effect for the first 4 months of the year, there will be either smaller tax payments or larger refunds when the individuals involved file their tax returns by April 15 of next year.

In terms of tax receipts, therefore, the standard deduction simplification measure will result in a reduction of receipts of $1.5 billion in fiscal year 1977 and $5.4 billion in fiscal year 1978. At current income levels the full year effect is a tax reduction of $4 billion.

The third feature of the tax reduction in the economic stimulus package is a business tax reduction. Here we are proposing that business be given the option of a 2 percentage point increase in the present generally applicable 10 percent investment credit or, alternatively, a refundable 4 percent credit against income tax based upon the payroll taxes paid for Social Security (FICA) tax purposes. Taxpayers will have their choice of the payroll tax credit or the investment credit increase but cannot take both. They will be required to elect between these two options and stay with their choice for a number of years.

The full year effect of this business tax change at current income levels is expected to be $2.6 billion a year. In fiscal year 1977 this will result in a tax reduction of $.9 billion and in fiscal year 1978, a reduction of $2.7 billion.

To summarize, the tax features of the proposal have a budget cost of $13.7 billion in fiscal year 1977. Most of this represents the cost of the tax rebate. The public works, public service employment, expanded training of youth program, and countercyclical revenue sharing expenditure programs are expected to add to this cost an additional $1.7 billion. For fiscal year 1977 this represents an overall cost of the program of $15.5 billion.

In fiscal year 1978 the components of the program shift substantially. The tax costs in that fiscal year are expected to be about $8 billion. There is no tax rebate in that year. On the other hand the expenditure programs for public works, public service, and countercyclical revenue sharing will by that time have filled up the "pipeline" and can be expected to result in expenditures of $7.6 billion. The combination of these tax measures and expenditure programs involve a budget cost in fiscal year 1978 of $15.7 billion. Table 1 summarizes the budget costs of this program.

Table 1

Budget Costs of the Administration's Stimulus and Tax Simplification and Reform Proposals

($ billions)

	Fiscal Year 1977	Fiscal Year 19
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns 1/	1.5	5
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	0.9	2.
Other expenditures program:		
Increased countercyclical revenue sharing	0.5	0.
Public service employment	0.7	3.
Public works	0.2	2
Expanded training and youth programs	0.3	1
Total other expenditures programs	1.7	7
Total administration proposals	15.5	15

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*Less than $50 million.

Note: Details may not add to totals due to rounding.

1/ Includes extension of the $35 general tax credit to exemptions for age and blindness.

Impact of Program on Credit Markets

I want to turn now to the question of the effect of the enlarged deficits for fiscal years 1977 and 1978 implied by these economic initiatives on the capital markets. The entire expenditure program is currently being reviewed and as a result it is impossible for us at this time to come up with an exact deficit figure for fiscal year 1977. However, it is believed that the fiscal year 1977 deficit will be in the range of $67 billion to $69 billion. This includes the effect of the stimulus proposal. Together with about $10 billion of off-budget financing, this would mean a draft by the Treasury on the credit markets in fiscal year 1977 of $77 billion to $79 billion. Some have questioned whether this prospective Treasury financing will "crowd out" other investments in the market.

Let us review our experience. It is true that non-Federal demands for funds have been rising from their recession lows since the latter part of 1975. We expect these trends to continue in 1977 and 1978. These demands, combined with total Treasury financing requirements, suggest a record level of total financing in the credit markets during calendar year 1977 of nearly $300 billion.

The supply of funds available to meet this large demand, including the Treasury's financing requirements, appears ample. Consumer savings should expand further, and it is likely that savings flows to investors will strengthen to about $150 billion. In addition, because this stimulus package is clearly not inflationary, it appears reasonable to anticipate that throughout 1977 and 1978 commercial and Federal Reserve banks will have the resources to purchase substantial amounts of credit market instruments. These sources of funds together with funds supplied by business corporations, State and local governments, the Federal Government and foreign investors will meet these demands without the need for substantial purchases by individuals.

In summary, my judgment is that the larger Federal deficits will not have a serious effect on the availability of financing for the private sector and will, therefore, have only a moderate impact on interest rates. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and the rate of real growth will not reach an unsustainable level. Thus, we are unlikely to be confronted with a situation of "crowding out".

International Economic Considerations

The present policies of the major nations suggest some slackening in the rate of growth among the industrial countries. As a result the developing nations will also encounter weaker markets for their products. Japan and Germany are expected to grow at a rate only somewhat less than in 1976, but in several of the other major economies -- such as the United Kingdom, France, Italy, and Mexico -- stabilization measures will lead to slower growth in the period immediately ahead.

It is important that those countries which are in a relatively strong financial position expand as rapidly as is consistent with sustained growth and the control of inflation. Expansion in those countries will provide stimulus for the weaker countries. But, it is easy to overestimate the magnitude of the contribution that faster growth in Japan, Germany, and the United States can make in fostering the needed adjustments of weaker countries. A 1 percent rise in the real GNP of the "big three" would result in an increase in their combined import demand on the order of $4 billion in 1977, of which only 60 percent, or about $2.4 billion, could directly benefit the financially weak countries.

In the period ahead when oil exporting countries are in a very large surplus position, the financially weak countries must reduce their deficits to preserve their credit worthiness. As a result this will tend to bring about a deterioration in the trade balances of the stronger countries. This means that the United States must expect a larger deficit in its current account balance. The key point here is that the weaker countries will of necessity reduce their current account deficits in accord with their ability to obtain financing.

To provide a better international economic climate, the United States is encouraging the major countries abroad which are in a strong financial position to follow a course of stimulating their economy much as we are proposing for the United States in this package.

Tax Rebate Provision

Let me now turn to the specifics of the tax rebate program. The rebate program of $50 per person as I indicated previously is designed to be as broadly applicable as it is administratively possible to provide. First, there is a general rebate of $50 for each taxpayer, spouse, child, and other dependent included on an income tax return for 1976. For those who had little or no tax liability the rebate will generally be refundable, along the lines of the present earned income credit. In other words, the $50 per person rebate will be paid in full even though this may exceed a family's tax liability. The only groups for whom the rebate will not be refundable will be single individuals, married couples with no dependents, or married couples with dependents, but no wage and salary income. For this group, the $50 credit will be available only to the extent of 1976 liability. Table 2 shows the distribution of this rebate by adjusted gross income class at 1976 levels of income. The total amount of the tax rebate is $9.6 billion distributed to more than 70 million tax return filers.

The second component of the stimulus package is aimed at those who may not be required to file tax returns. This conponent provides a payment of $50 to all beneficiaries under the Social Security, supplemental security income, and Railroad Retirement programs. Thirty-six million beneficiaries will receive these payments at a total cost of $1.8 billion.

Some have argued that a one-shot stimulus, such as a tax rebate, will have little or no stimulative effect. They argue that consumers, seeing that the tax credit is just temporary, will not change their spending patterns, but will instead save the entire rebate.

I believe that the effect of a rebate depends significantly on the condition of the economy and that under present circumstances a rebate will be rapidly spent. It may be true that when economic conditions have been good for some time, consumer spending and saving plans are relatively stable as families adjust their spending appropriately to their income, both present and anticipated. Under such circumstances, people receiving a "windfall" in the form of a temporary tax cut probably will spend only a portion of it, saving the rest.

Table 2

Estimated Effects of the Administration's Tax Rebate Program, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-984	10.3	10.3
5 - 10	-2,010	21.0	31.2
10 - 15	-2,223	23.2	54.4
15 - 20	-1,904	19.9	74.3
20 - 30	-1,695	17.7	92.0
30 - 50	-564	5.9	97.9
50 - 100	-169	1.8	99.6
100 or more	-36	0.4	100.0
Total	-9,585	100.0	

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Note: Details may not add to totals due to rounding.

But recent economic circumstances have been neither good nor stable. We have had combined inflation and stagnation for several years, with unemployment at its highest levels in decades. Most families' real income expectations have been repeatedly disappointed. Even when wage increases have been achieved, inflation has rapidly eroded these increases, leaving many families worse off than they were before. This has two consequences. First: most consumers have not been able to keep their consumption spending at a level which they consider satisfactory. There is, in my judgment, a significant willingness to consume that the rebate program will tap. Second: because the economy is recovering, consumer confidence is also on the rise. This provides a further reason for spending rather than saving the rebate.

Tax Simplification and Reform

Another part of this package is designed not only to provide a stimulus for the economy but also to simplify the tax laws. This is the first step in our long range tax reform and simplification proposals.

One source of complexity under present law is the standard deduction provision. Presently the standard deduction for single people is 16 percent of adjusted gross income, but not less than $1,700 or more than $2,400. In the case of married couples the standard deduction is 16 percent of adjusted gross income, but in this case not less than $2,100 or more than $2,800. Everyone claiming the standard deduction, even though using the tax table, must make this calculation.

The proposal which the Administration is presenting would substitute for the complicated set of standard deduction provisions a flat dollar amount of $2,400 for single people and $2,800 for married couples. These are the present maximum standard deductions for single and married persons, respectively. The flat dollar standard deduction not only is easier to compute than the variable credit but in addition makes it possible to fold the standard deduction into the tax tables and rate structure. This in effect means that there would not even be a separate computation of the standard deduction, as there is at present. Instead, the tax tables will incorporate the new standard deduction.

Even taxpayers who itemize their deductions will be able to use the tax tables, or rate structures, with the standard deduction built in. They will simply subtract from their income the excess of their itemized deductions over the flat standard deduction, and then turn to the tax tables.

In addition, the new tax tables will have built in computations of personal exemptions and the general tax credit. Under present law, taxpayers must make all of these calculations themselves. For example, the general tax credit involves a choice between a per capita credit of $35 and an alternative credit of up to $180 based on the first $9,000 of taxable income.

The new tax tables will not require any of these calculations. The tables will have different columns for the different numbers of exemptions. After having added up his income, an individual with three exemptions would simply look down the tax table in the column referring to three exemptions and read off from the table his tax liability. For a taxpayer who had no special credits, this would be his final tax. To determine his tax payment or refund then due, he would only have to subtract the tax which he had already paid by way of withholding or in some other form. The tax tables will be available to all taxpayers with incomes under $25,000 or $30,000, the bulk of all taxpayers. To make this simplification possible, exemptions for the aged and blind will qualify for the $35 credit.

This change in the standard deduction will result in an annual revenue loss of about $4 billion a year. However, because the provision will be effective for only a portion of fiscal year 1977 and also because withholding changes with respect to this standard deduction probably cannot be made until about the first of May, the revenue impact in fiscal year 1977 is expected to be only about $1.5 billion. In fiscal year 1978, the revenue loss is expected to be about $5.4 billion, which exceeds the full year cost because of refunds generated by the late start in withholding.

The tax reduction as a result of the change in the standard deduction affects only those with incomes of $17,500 or less in the case of married couples or $15,000 or less in the case of single persons. As is shown in Table 3 a very large portion of the reduction resulting from the

Table 3

Estimated Effects of the Administration's Flat Standard Deduction Proposal, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the $2,400/$2,800 standard deduction 1/		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-616	15.6	15.6
5 - 10	-1,953	49.4	65.0
10 - 15	-1,245	31.5	96.5
15 - 20	-137	3.5	100.0
20 - 30	-1	*	100.0
30 - 50	-*	*	100.0
50 - 100	-*	*	100.0
100 or more	-*	*	100.0
Total	-3,951	100.0	

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Note: Details may not add to totals due to rounding.

*Less than $500 thousand or 0.05 percent.

1/ Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

standard deduction change is concentrated in the lower income levels. This table shows that 65 percent of the reduction goes to those with income below $10,000. Table 4 shows the reduction in tax liabilities for representative taxpayers who use the standard deduction. For example, a family of four with earnings of $10,000 will have its taxes reduced by $133 (from $651 to $518).

The new standard deduction will exceed the itemized deductions of approximately 4 million taxpayers who currently itemize. Accordingly, we expect the percentage of all filers using the standard deduction to rise from approximately 69 percent to 74 percent.

These tax changes will also insure that persons at or below the poverty level will pay no income tax. Table 5 shows the levels of tax-free income and the projected poverty levels for the years 1977 and 1979. While the standard deduction changes raise the tax-free level somewhat above the expected poverty level in 1977, generally this will no longer be true by 1979.

Business Tax Reductions

To provide further stimulus for economic expansion, we also provide a program of business tax reductions.

Each firm will choose, but on a long-term binding basis, between two tax credits: (1) a refundable credit against income taxes of 4 percent of the employer's share of Social Security payroll taxes (currently 5.85 percent of taxable payrolls) or (2) an additional 2 percent investment tax credit (generally from 10 to 12 percent) for all investment outlays which are currently eligible. The self employed will choose between the additional investment tax credit or 2 percent of the self employed payroll tax (currently 7.9 percent) plus, of course, 4 percent of any other payroll taxes they have. These credits will apply to eligible equipment placed in service after January 1, 1977, or to Social Security taxes on payroll costs incurred after January 1, 1977.

It is well known that business firms do not benefit uniformly from the current investment tax credit. Relatively labor-intensive firms, those engaged primarily in the service trades, and non-profit institutions paying the Social Security tax may not be eligible for the investment

Table 4

The Flat Standard Deduction Proposal for 1977:
Tax Changes for Representative Taxpayers

Filing status	Adjusted gross income	1976 law tax	Proposed 1977 tax 2/	Tax change
Single:	$ 3,000	$ 42.50	$ 0	$- 42.50
	5,000	363.50	247.50	-116.00
	7,000	714.50	584.50	-130.00
	10,000	1,331.00	1,177.00	-154.00
Joint return:	5,000	130.00	28.00	-102.00
	7,000	448.00	332.00	-116.00
	10,000	948.00	829.00	-119.00
	15,000	1,882.00	1,794.00	-88.00
Family of four:	7,000	35.00 1/	-70.00 1/	-105.00
	10,000	651.00	518.00	-133.00
	15,000	1,552.00	1,464.00	-88.00

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1/ Assumes use of the earned income credit.

2/ The proposal would increase the minimum standard deduction to $2,400, or, for joint returns, $2,800.

Note: Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

Table 5

Tax-free Levels and Projected Poverty Levels

(dollars)

	Tax-free levels		Projected poverty levels 1/	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	2,700	3,400	3,107	3,439
Couple without dependents	4,100	4,800	4,018	4,448
Family of four	6,100	6,800	6,110	6,763

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1/ Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

tax credit and therefore derive few or no benefits from this provision of tax law. It is partly for this reason that the alternative credit against payroll taxes is proposed for such firms or organizations. Another reason is that the new device should directly encourage increased employment. The payroll tax credit will be fully refundable so that all firms, whether or not they have current income tax liability, will be able to reduce their payroll costs through this program.

In 1977, this program will reduce business tax liabilities by $2.6 billion. Of this total $1.1 billion would result from the use of the payroll tax credit and $1.5 billion from the use of the higher investment credit.

Countercyclical Revenue Sharing

Existing law, in addition to general revenue sharing, makes provision for the expenditure of $1.25 billion (for the period which began last July) for countercyclical revenue sharing. Under this program, funds are allocated on a quarterly basis of $125 million plus $62.5 million for each half percentage of national unemployment over 6 percent. When national unemployment falls to 6 percent, this latter part of the program turns off. At the national unemployment rate of about 8 percent for the fourth quarter of the calendar year 1976, all funds appropriated by Congress for this program will be exhausted by April of 1977.

Under this program, funds are distributed to over 20,000 State and local governmental units on the basis of their unemployment rates in excess of 4-1/2 percent and the fiscal year 1976 general revenue sharing amounts. One third of these amounts are distributed to State governments and two thirds to localities.

It appears that the current allocation formula has targeted funds effectively. For example, three quarters of all local funds in the third quarterly payment went to governmental units with unemployment rates in excess of 8 percent. Similarily, central cities and governments in States with higher unemployment rates receive larger per capita antirecession payments. Compared to general revenue sharing, allocations are more heavily concentrated in cities of 100,000 or more population and counties of 200,000 or more population.

The President's economic stimulus package both expands and modifies somewhat the operation of the countercyclical revenue sharing program. Under the stimulus package this program would first of all be given a 4 year authorization with annual appropriations as compared to the current authority which covers only five quarters.

Second, an additional $1 billion would be made available for distribution beginning in July of 1977. These new funds would be triggered only in response to national unemployment in excess of 6 percent.

Finally, the indexing of the total quarterly funding would be made more sensitive to changes in the unemployment rate under the stimulus proposal. Instead of increasing $62.5 million for every full half percentage point of unemployment over 6 percent as is currently true, each change of one tenth of a percentage point would result in the increase funding of an additional $29.2 million.

While it is difficult to forecast exactly how the additional $1 billion of countercyclical revenue sharing funds will be spent in fiscal years 1977 and 1978, our current estimates suggest that this will result in an increase in spending in the fiscal year 1977 of $500 million and in fiscal year 1978 of $600 million. If unemployment is higher than anticipated the expenditures in fiscal 1977 might be larger than indicated.

Let me conclude by emphasizing both the balanced nature of this program as well as the flexibility of our overall stimulus package in meeting the needs of the economy. Our proposals are balanced in that they provide an immediate injection of spending into the economy while at the same time taking the first step towards tax simplification and tax reform. Moreover, the stimulus provided from lower taxes and accelerated spending can be flexibly adjusted to economic conditions as we recover from the worst recession in 40 years.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE January 26, 1977

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for $2,930 million, or thereabouts, of 364-day Treasury bills to be dated February 8, 1977, and to mature February 7, 1978 (CUSIP No. 912793 M3 7). The bills, with a limited exception, will be available in book-entry form only, and will be issued for cash and in exchange for Treasury bills maturing February 8, 1977.

This issue will not provide new money for the Treasury as the maturing issue is outstanding in the amount of $2,930 million, of which $2,027 million is held by the public and $903 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 par amount will be payable without interest. Except for definitive bills in the $100,000 denomination, which will be available only to investors who are able to show that they are required by law or regulation to hold securities in physical form, this series of bills will be issued entirely in book-entry form on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Wednesday, February 2, 1977. Form PD 4632-1 should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

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.

(OVER)

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.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities, for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches, or for definitive bills, where authorized. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

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 for bills to be maintained on the records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on February 8, 1977, in cash or other immediately available funds or in Treasury bills maturing February 8, 1977. 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 a 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 Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE January 26, 1977

TREASURY FEBRUARY QUARTERLY FINANCING

The Treasury will raise about $3,700 million of new cash and refund $2,068 million of securities maturing February 15, 1977, by issuing $3,000 million of 3-year notes, $2,000 million of 7-year notes, and $750 million of 30-year bonds.

The $2,068 million of maturing securities to be refunded in the general offering are those held by the public. Government accounts and Federal Reserve Banks, for their own accounts, hold $3,095 million of maturing securities that may be refunded by issuing additional amounts of new securities. Additional amounts of the notes and the bonds may also be issued, for new cash only, to Federal Reserve Banks as agents for foreign and international monetary authorities.

Details about each of the new securities are given in the attached "highlights" of the offering and in the official offering circulars.

In a separate release today the Treasury announced its regular 52-week bill offering in the amount of $2,930 million to refund maturing bills in a like amount.

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Attachment

HIGHLIGHTS OF TREASURY
OFFERINGS TO THE PUBLIC
FEBRUARY 1977 REFUNDING
TO BE ISSUED FEBRUARY 15, 1977

January 26, 1977

Amount Offered:			
To the public	$3,000 million	$2,000 million	$750 million
Description of Security:			
Term and type of security	3-year notes	7-year notes	30-year bonds
Series and CUSIP designation	Series G-1980 (CUSIP No. 912827 GK 2)	Series A-1984 (CUSIP No. 912827 GL 0)	Bonds of 2002-2007 (CUSIP No. 912810 BX 5)
Maturity date	February 15, 1980	February 15, 1984	February 15, 2007
Call date	No provision	No provision	February 15, 2002
Interest coupon rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates	August 15 and February 15	August 15 and February 15	August 15 and February 15
Minimum denomination available	$5,000	$1,000	$1,000
Terms of Sale:			
Method of sale	Yield Auction	Yield Auction	Yield Auction
Accrued interest payable by investor	None	None	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less
Deposit requirement	5% of face amount	5% of face amount	5% of face amount
Deposit guarantee by designated institutions	Acceptable	Acceptable	Acceptable
Key Dates:			
Deadline for receipt of tenders	Tuesday, February 1, 1977, by 1:30 p.m., EST	Thursday, February 3, 1977, by 1:30 p.m., EST	Friday, February 4, 1977, by 1:30 p.m., EST
Settlement date (final payment due)			
a) cash or Federal funds	Tuesday, February 15, 1977	Tuesday, February 15, 1977	Tuesday, February 15, 1977
b) check drawn on bank within FRB district where submitted	Thursday, February 10, 1977	Thursday, February 10, 1977	Thursday, February 10, 1977
c) check drawn on bank outside FRB district where submitted	Wednesday, February 9, 1977	Wednesday, February 9, 1977	Wednesday, February 9, 1977
Delivery date for coupon securities	Tuesday, February 15, 1977	Tuesday, February 15, 1977	Friday, February 18, 1977

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE January 28, 1977

GERARD TO JOIN DILLON READ AS VICE PRESIDENT

Robert A. Gerard, former Assistant Secretary of the Treasury for Capital Markets and Debt Management, is joining the New York investment banking firm of Dillon Read & Co. Inc., as a vice president. He will continue for a brief period in an advisory capacity at Treasury, however, for transition purposes. His resignation as Assistant Secretary was accepted by President Ford effective January 20.

Deputy Secretary of the Treasury Designate Kenneth S. Axelson, who worked closely with Gerard when Axelson served as Deputy Mayor of New York City, commented:

"Secretary Blumenthal and I are deeply grateful to Bob Gerard for assisting us during the period of transition. Bob's thorough understanding of the complex financial problems which face the various levels of government in our nation, has already proved to be extremely valuable to the new team at Treasury."

Mr. Gerard entered public service with Treasury in December 1974. He was appointed Assistant Secretary by President Ford in March 1976. In the latter capacity he has been the principal advisor to the Secretary of the Treasury in matters relating to domestic finance, including management of the national debt and the New York City financial situation.

In recently awarding him the Exceptional Service Award of the Treasury Department, former Secretary William E. Simon noted:

"Bob Gerard epitomizes those qualities of professional excellence and personal capability which are the very foundation of sound and effective public policymaking. He has earned the friendship, affection and respect of all those who have known him in his many roles, both within and outside of public service."

Gerard, 32, a native of New York City, was associated with the Washington law firm of Wilmer, Cutler & Pickering prior to his government service. He is a graduate cum laude of Harvard University, and magnum cum laude of Columbia University Law School.

He is married to the former Elizabeth C. Gallatin. They have two children, Celia Coolidge and Robert Gallatin and plan to reside in New York City.

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DATE: January 31, 1977

TREASURY BILL RATES

	13-WEEK	26-WEEK
LAST WEEK:	4.760 %	4.905 %
TODAY:	4.720 %	5.008 %
HIGHEST SINCE 11-15-76 :	4.890 %	5.018 %
LOWEST SINCE :		

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THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE January 31, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,600 million of 13-week Treasury bills and for $3,700 million of 26-week Treasury bills, both series to be issued on February 3, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 5, 1977			26-week bills maturing August 4, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.813	4.696%	4.82%	97.479	4.987%	5.19%
Low	98.803	4.735%	4.86%	97.462	5.020%	5.22%
Average	98.807	4.720%	4.84%	97.468	5.008%	5.21%

Tenders at the low price for the 13-week bills were allotted 24%.
Tenders at the low price for the 26-week bills were allotted 27%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 25,210,000	$ 23,210,000	$ 63,025,000	$ 44,295,000
New York	3,791,115,000	1,984,115,000	5,843,040,000	3,285,990,000
Philadelphia	50,450,000	50,450,000	8,525,000	8,525,000
Cleveland	60,620,000	60,620,000	130,650,000	29,650,000
Richmond	28,380,000	23,360,000	18,300,000	6,800,000
Atlanta	20,530,000	20,530,000	15,530,000	10,815,000
Chicago	288,340,000	84,580,000	443,340,000	67,110,000
St. Louis	42,110,000	29,830,000	34,745,000	13,285,000
Minneapolis	32,185,000	32,185,000	17,670,000	15,480,000
Kansas City	44,795,000	43,795,000	50,875,000	21,360,000
Dallas	142,940,000	137,940,000	22,305,000	12,305,000
San Francisco	141,685,000	109,665,000	329,025,000	184,755,000
Treasury	---	---	110,000	110,000
TOTALS	$4,668,360,000	$2,600,280,000 a/	$6,977,140,000	$3,700,480,000 b/

a/Includes $332,060,000 noncompetitive tenders from the public.
b/Includes $126,070,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

Department of the TREASURY NEWS
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For Release on Delivery

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE HOUSE APPROPRIATIONS COMMITTEE
WASHINGTON, D.C., TUESDAY, FEBRUARY 1, 1977 10:00 A.M.

Mr. Chairman and members of this distinguished Committee:

It is an honor to appear before you in support of the President's program for economic recovery.

Mr. Schultze has indicated why we believe the economy needs a degree of stimulus and what effects this program will have on the economy.

Let me explain the strategy behind the President's program. First, this program has a 2-year time perspective -- the years 1977 and 1978. We wish to enable consumers and businesses to plan ahead. Secondly, the program contains a good deal of flexibility. As we continually monitor the improvement in the economy, we can either add additional stimulus or cut back to meet changing economic conditions. Third, the program promises only what can be realistically undertaken. We are proposing major increases in existing programs within a short period of time. To force more stimulus, or to force it faster, into our economic system would exceed our ability to administer the programs in a responsible manner.

This program will stimulate higher levels of economic activity by encouraging consumer and business confidence and related spending. It thus should reduce the presently intolerable level of unemployment, increase government revenues and help achieve the President's goal of a balanced budget by fiscal 1981.

I will outline for you the international economic factors involved in this program, and provide detail on certain tax and spending aspects of the package. I also will indicate the program's likely effects on the capital markets.

International Economic Considerations

Mr. Schultze has discussed domestic economic factors in detail; let me summarize certain international economic factors which also argue for this stimulus program.

First, we must recognize that we increasingly participate in a global economy. American economic health is importantly affected by conditions in our export markets. The other industrialized countries are even more dependent on our economy. In turn, the developing nations are critically dependent on demands for their products from the industrialized world. In short, these economies are interdependent.

Second, just as we recently experienced a pronounced economic pause at home, a similar slowing of growth among the industrial countries has been evident. Japan and Germany are expected to grow at a slightly lower rate than in 1976; several of the other major economies -- such as the United Kingdom, France, Italy, and Mexico -- are facing even slower growth in the period immediately ahead. There is only one industrial country -- Switzerland -- which is not experiencing near record unemployment. In addition, inflation continues at levels which would be unacceptable even at full employment. Only in Germany and Switzerland is the current inflation rate below 4%.

In addition to these twin problems of unemployment and inflation, a number of nations, both industrial and developing, are becoming concerned about their ability to continue to finance current balance of payments deficits. External debts have risen dramatically. In some cases, there is little confidence in the ability of governments to maintain economic expansion, reduce unemployment, and control inflation.

It is important that those countries which have greater economic and financial resources expand as rapidly as is consistent with sustained growth and the control of inflation. Expansion in those countries will provide stimulus for other industrialized countries and for weaker developing countries.

To provide a better international economic climate, the United States is asserting leadership and encouraging the stronger countries abroad to follow suit. We are implicitly and explicitly asking them to follow a course of stimulating their economies much as we are proposing for the United States in this package.

In the period ahead when oil exporting countries are in a very large surplus position, the financially weak countries must reduce their payments deficits to preserve their credit worthiness. This will tend to bring about a deterioration in the trade balances of the stronger countries. This means that the United States must expect a larger deficit in its current account balance. The key point here is that the weaker countries will of necessity reduce their current account deficits and must depend on us for export-led growth.

The Stimulus Program

Let me turn now to the stimulus program itself.

The tax features of the program have a two-fold purpose: to provide a quick injection of spending into the national economy and also to take the first step in a tax simplification and tax reform program.

In broad terms, stimulus to the economy will be provided by a payment of $50 per capita to almost everyone. This will be accomplished by a general refundable rebate on 1976 taxes of $50 for each taxpayer and each dependent. For those who have either no dependents or no earned income, this rebate will not exceed the amount of 1976 tax liability. Also, a payment of $50 per beneficiary will be made to Social Security beneficiaries, those receiving supplemental security income payments (SSI), and those receiving Railroad Retirement payments.

The $50 per person rebate and Social Security payment will amount to about $11.4 billion. The payments will largely be made this Spring and the total rebate payments should fall entirely on fiscal year 1977.

The second tax feature in the program is a simplification measure, designed to streamline the tax laws for those presently using the standard deduction. This involves enlarging the standard deduction for joint returns with incomes of $17,500 or less and single returns with incomes of $15,000 or less. The program substitutes a flat deduction of $2,400 for single people, and $2,800 for married couples, for the present complex set of standard deduction provisions.

This increase in the standard deduction will apply for the entire calendar year 1977 as well as subsequent years. However, this tax reduction cannot be reflected in lower withholding until approximately a month after the date of the enactment of the bill. We are assuming that the required withholding changes can become effective as of the first of May. Since the lower withholding will not be in effect for the first 4 months of the year, there will be either smaller tax payments or larger refunds when the individuals involved file their tax returns by April 15 of next year.

In terms of revenue loss, therefore, this simplification measure will cost $1.5 billion in fiscal year 1977 and $5.4 billion in fiscal year 1978. At current income levels, the full year effect is $4 billion.

The third tax feature is a business tax reduction. We are proposing that business be given the option of a 2 percentage point increase in the present 10 percent investment credit or, alternatively, a refundable 4 percent tax credit for payroll taxes paid for Social Security (FICA) tax purposes. Businesses will have a choice but cannot take both. They will be required to stay with their choice for a number of years.

The full year effect of this business tax cut at current income levels is $2.6 billion. In fiscal year 1977 this will cost $.9 billion and, in fiscal year 1978, $2.7 billion.

To summarize, the tax features of the proposal have a budget cost of $13.7 billion in fiscal year 1977. Most of this represents the cost of the tax rebate. In fiscal year 1978 the tax budget cost is expected to be about $8 billion. This decrease is, of course, attributable to the fact that the rebate is for the year 1977 only.

Let me now address the spending components of the program.

The spending elements of the package were chosen on three criteria: First, and most important, the programs had to create jobs. We wanted the maximum new employment for each dollar spent. Second, the programs had to be effective, and subject to a well administered expansion. We were not interested in creating waste, confusion, or corruption. Third, the programs had to be vulnerable to reasonably rapid termination. We did not wish to mortgage billions of dollars of future tax revenues in the first few days of the Administration.

Within these limits, our spending program is an aggressive one:

For local public works, we recommend an increased authorization of $4 billion, to be spent over 2 years as quickly as good management allows. We are asking increased appropriations of $2.0 billion in both fiscal year 1977 and fiscal year 1978. We estimate that only $0.2 billion of this can be spent in what remains of fiscal year 1977, but this is an informed guess, not a ceiling. In fiscal year 1978, we expect a full $2.0 billion increase in outlays.

For new jobs programs, we are aiming for $1.0 billion in increased outlays this fiscal year, and $5.0 billion in fiscal year 1978. The impact on jobs will be dramatic once the spending begins to flow heavily: We project, by fiscal year 1978, an increase of 415,000 jobs in public service employment and of 346,000 training and youth slots under other provisions of the Comprehensive Employment and Training Act. This is an unprecedented jobs program, both in its size and in the sophistication and fairness of its several elements. The Labor Department cannot efficiently manage any larger expansion in so short a time.

Finally, we propose an expansion and reform of countercyclical revenue sharing -- changes designed to distribute, at current unemployment rates, $1 billion a year more than does the present system. These funds will combat unemployment by saving hard-pressed State and local governments from having to contract their payrolls.

Because countercyclical revenue sharing is administered by the Treasury Department, allow me to say a word more about this element of the stimulus package:

Existing law provides for the expenditure of $1.25 billion for countercyclical revenue sharing. Under this program, funds are allocated on a quarterly basis of $125 million plus $62.5 million for each half percentage of national unemployment over 6 percent. When national unemployment falls to 6 percent, this latter part of the program turns off. At the current national unemployment rate, about 8 percent, all funds appropriated by Congress for this program will be exhausted by April of 1977.

The program has targeted funds quite effectively. For example, three quarters of all local funds in the third quarterly payment went to governmental units with unemployment rates in excess of 8 percent.

The President's economic stimulus package both expands and reforms the program. The program would be given a 4 year authorization, with annual appropriations, as compared to the current authority which covers only five quarters. Thus, the "trigger" would remain in place over the whole business cycle, a sound precaution against any sudden downturn in the years ahead. An additional $1 billion would be made available for distribution beginning in July of 1977. Finally, the funding would be made more sensitive to changes in the unemployment rate. Instead of increasing $62.5 million for every half percentage point of unemployment over 6 percent, as is currently true, each change of one tenth of a percentage point in unemployment would result in an additional $29.2 million in funding.

For this program, we currently estimate an increase in spending in fiscal year 1977 of $500 million and in fiscal year 1978 of $600 million. If unemployment is higher than anticipated, the expenditures in fiscal 1977 might be larger than indicated.

Effects of the Simulus Program on the Overall Economy

The Administration believes that this stimulus program will have the following, general effects on our economy.

The tax rebate will almost immediately put funds into the hands of consumers, increase their spending, and thus encourage higher levels of overall economic activity. Such an immediate stimulus must be provided through a rebate because public service employment or accelerated public works cannot be expanded fast enough to achieve this objective in the few remaining months of fiscal year 1977.

In fiscal 1978 the spending programs will strike heavily at unemployment, particularly among construction workers, veterans, and minorities.

With this program, it is expected that the unemployment rate will decline to between 6.7 and 6.9 percent by the fourth quarter of 1977 and fall further in 1978, approaching the 6 percent level by the end of that year.

Also the real gross national product, given this program, should increase during calendar year 1977 by about 5-3/4 to 6 percent, as contrasted to only about 4-1/2 or 4-3/4 percent in the absence of the program.

While this program will provide the needed economic stimulus, we do not expect it to cause any significant increase in the rate of inflation. The present high unemployment rate and the substantial unused industrial capacity -- still approaching 20 percent -- indicate that inflationary pressures are subdued now and probably can remain so. Increased prices that do occur will primarily reflect the momentum for price increases which has not yet worked its way out of the economic system.

Impact of Program on Federal Budget Deficits and Credit Markets

I turn now to the effect of the economic stimulus program on the Federal budget deficits and, in turn, the effect of these on the capital markets. The entire federal budget is currently being reviewed by the Administration and, as a result, it is impossible for us at this time to provide a precise deficit figure for the fiscal year 1977. However, we believe that the fiscal year 1977 deficit will be in the range of $67 billion to $69 billion, including the effect of the President's stimulus proposal.

A deficit in this range, together with about $10 billion of off-budget financng, will mean a call by the Treasury on the credit market in fiscal year 1977 of $77 billion to $79 billion. Questions have been raised as to whether this prospective Treasury financing will "crowd out" other investments in the capital market.

It is true that non-Federal demands for funds have been rising from their recession lows since the latter part of 1975. These trends can be expected to continue in 1977 and 1978. Combining these demands with total Treasury financing requirements suggest a level of total financing in the credit market during the calendar year 1977 of nearly $300 billion.

The question, of course, is whether the supply of funds available will be sufficient to meet this demand. Our examination has led us to conclude that the supply of funds will be ample. First, consumer savings should expand further and it is likely that saving flows to financial institutions will amount to about $150 billion. In addition, because this stimulus package is not inflationary, it appears reasonable to anticipate that throughout 1977 and 1978 commercial and Federal Reserve banks will have the resources to purchase substantial amounts of credit market instruments. These sources of funds together with funds supplied by business corporations, State and local governments, the Federal government, and foreign investors should meet the demand for funds without the need for substantial purchases by individuals.

In summary, my judgment is that the temporarily larger Federal deficit will not have a serious effect on the availability of financing for the private sector and will, therefore, have only a moderate impact on interest rates. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and the real rate of growth will not reach an unsustainable level. Thus, I do not believe that we will be confronted with a situation where Federal financing requirements crowd out funds needed by the private sector.

In sum, Mr. Chairman, the new President has devised a prudent, balanced and flexible program. It is prudent in phasing in increased spending no faster than managerial competence will allow and in limiting that spending to programs that can, and will, be phased out in better economic times. The program is balanced in matching immediate stimulus with movement toward tax simplification and reform. Finally, the program is flexible in allowing us, the Administration and Congress working together, to adjust the various elements to the unpredictable turns and twists of the economy. I urge your support for this program.

I thank you.

Table 1

Budget Costs of the Administration's Stimulus and Tax Simplification and Reform Proposals

($ billions)

	Fiscal Years 1977	Fiscal Years 1978
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns 1/	1.5	5.5
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	0.9	2.7
Other expenditures program:		
Increased countercyclical revenue sharing	0.5	0.6
Public service employment	0.7	3.4
Public works	0.2	2.0
Expanded training and youth programs	0.3	1.6
Total other expenditures programs	1.7	7.6
Total administration proposals	15.5	15.7

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

*Less than $50 million.

Note: Details may not add to totals due to rounding.

1/ Includes extension of the $35 general tax credit to exemptions for age and blindness.

Table 2

Estimated Effects of the Administration's Tax Rebate Program, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	..............)
Less than 5	-984	10.3	10.3
5 - 10	-2,010	21.0	31.2
10 - 15	-2,223	23.2	54.4
15 - 20	-1,904	19.9	74.3
20 - 30	-1,695	17.7	92.0
30 - 50	-564	5.9	97.9
50 - 100	-169	1.8	99.6
100 or more	-36	0.4	100.0
Total	-9,585	100.0	

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January 26, 1977

Note: Details may not add to totals due to rounding.

Table 3

Estimated Effects of the Administration's Flat Standard Deduction Proposal, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the $2,400/$2,800 standard deduction 1/		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	..............)
Less than 5	-616	15.6	15.6
5 - 10	-1,953	49.4	65.0
10 - 15	-1,245	31.5	96.5
15 - 20	-137	3.5	100.0
20 - 30	-1	*	100.0
30 - 50	-*	*	100.0
50 - 100	-*	*	100.0
100 or more	-*	*	100.0
Total	-3,951	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

*Less than $500 thousand or 0.05 percent.

1/ Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

Table 4

The Flat Standard Deduction Proposal for 1977:
Tax Changes for Representative Taxpayers

Filing status	Adjusted gross income	1976 law tax	Proposed 1977 tax 2/	Tax change
Single:	$ 3,000	$ 42.50	$ 0	$- 42.50
	5,000	363.50	247.50	-116.00
	7,000	714.50	584.50	-130.00
	10,000	1,331.00	1,177.00	-154.00
Joint return:	5,000	130.00	28.00	-102.00
	7,000	448.00	332.00	-116.00
	10,000	948.00	829.00	-119.00
	15,000	1,882.00	1,794.00	-88.00
Family of four:	7,000	35.00 1/	-70.00 1/	-105.00
	10,000	651.00	518.00	-133.00
	15,000	1,552.00	1,464.00	-88.00

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Assumes use of the earned income credit.

2/ The proposal would increase the minimum standard deduction to $2,400, or, for joint returns, $2,800.

Note: Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

Table 5

Tax-free Levels and Projected Poverty Levels

(dollars)

	Tax-free levels		Projected poverty levels 1/	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	2,700	3,400	3,107	3,439
Couple without dependents	4,100	4,800	4,018	4,448
Family of four	6,100	6,800	6,110	6,763

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January 26, 1977

1/ Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: J.C. Davenport
Extension: 2951
February 1, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES DUMPING FINDING ON IMPORTS OF MELAMINE FROM JAPAN

Acting Assistant Secretary of the Treasury John H. Harper announced today that he was issuing a finding of dumping under the Antidumping Act with respect to imports of melamine in crystal form from Japan. The finding will be published in the Federal Register of February 2, 1977.

On September 17, 1976, the Treasury Department determined that melamine in crystal form from Japan is being, or is likely to be, sold at less than fair value within the meaning of the Antidumping Act, 1921, as amended.

On December 20, 1976, the United States International Trade Commission advised the Secretary of the Treasury that an industry in the United States is being injured and is likely to be injured by reason of the importation of the subject merchandise from Japan, sold, or likely to be sold, at less than fair value.

After these two determinations, the finding of dumping automatically follows as the final administrative requirement in antidumping investigations.

Imports of melamine in crystal form from Japan were valued at approximately $1.4 million during calendar year 1975.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. February 1, 1977

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 million, or thereabouts, to be issued February 10, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,700 million, or thereabouts, representing an additional amount of bills dated November 12, 1976, and to mature May 12, 1977 (CUSIP No. 912793 G2 6), originally issued in the amount of $3,702 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,700 million, or thereabouts, to be dated February 10, 1977, and to mature August 11, 1977 (CUSIP No. 912793 J5 6).

The bills will be issued for cash and in exchange for Treasury bills maturing February 10, 1977, outstanding in the amount of $6,407 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,131 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, February 7, 1977.
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

(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 or at the Bureau of the Public Debt on February 10, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 10, 1977. 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, or from the Bureau of the Public Debt.

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REPORT ON DEVELOPING COUNTRIES

EXTERNAL DEBT AND DEBT RELIEF

PROVIDED BY THE UNITED STATES.

JANUARY 1977

THE SECRETARY OF THE TREASURY
WASHINGTON

JAN 13 1977

Dear Mr. Speaker:

I am pleased to submit, as required by Section 634(g) of the Foreign Assistance Act of 1961, as amended, the third annual report on the debt situation in the developing countries and the debt relief provided by the United States.

The report provides a historical perspective of the LDC debt situation as of December 1974, 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 1975-1976 and the implications of these trends for LDC debt. The report also contains information on the one major debt rescheduling in which the United States participated in fiscal year 1976.

I hope this information will be of use to you and other members of the House.

Sincerely ~~yours~~,

William E. Simon

The Honorable
Thomas P. O'Neill, Jr.
Speaker of the House of Representatives
Washington, D.C. 20515

Enclosure

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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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I. SUMMARY AND CONCLUSIONS

External public debt outstanding of the less developed countries (LDC's) totalled $151 billion at the end of calendar year 1974, the latest date for which complete debt data are available. When adjusted for the effects of inflation, the debt outstanding and debt service payments of the LDC's in 1974 were less than that of 1972. (In 1975 and 1976, however, the debt burden appears to have increased for a number of LDC's.)

Fifteen countries account for about two-thirds of the debts of the non-oil LDC's. For calendar year 1975, these same fifteen countries financed a major portion of the deficit in current account of their balance of payments by increasing their net long-term liabilities, by borrowing from the International Monetary Fund, and by contracting other liabilities, all on the order of some $7 billion. For calendar year 1976, non-oil LDC borrowings are likely to be larger than would be expected, based on the estimated size of their deficit: the developing countries have been rebuilding reserves (which were reduced to a low level relative to imports) at a rate of $3 billion in the first six months of 1976.

The meaning of these figures on LDC external indebtedness is best understood in a global context. In light of the persistence of the OPEC current-account surplus, the LDC position can improve only to the extent that the industrial countries' aggregate deficit increases. In 1975, the recession in the industrial countries markedly improved the current-account position of several major industrial trading nations, especially the United States, leaving the non-oil LDC's to absorb an extensive share of the deficit required to offset the OPEC surplus. In 1976, the recovery in the OECD countries increased the import demand of those countries, and their aggregate current-account position turned from surplus to deficit. This permitted the LDC trade and current-account deficits to show some improvement, as their export markets expanded while lower growth targets in some LDC's reduced their import demand. The aggregate deficit of the oil-importing countries was thus divided more evenly between developing and developed countries in 1976, although the LDC's remained the larger absorber and continued to borrow at a rate above the historic trend.

constraint on development, the developing countries, as a group, have pressed for relief of debts. The issue of LDC indebtedness received major consideration in 1976 at the Fourth United Nations Conference on Trade and Development (UNCTAD IV) and the Conference on International Economic Cooperation (CIEC). At the UNCTAD Conference, no merging of views resulted from debating proposals on debt put forward by the developing and developed countries. Countries, therefore, agreed to a procedural resolution leading to continued discussion in other international bodies.

At the CIEC, the developing countries put forward wide-ranging proposals on debt, including forgiveness of bilateral official debts of certain major groups of developing countries, and consolidation and rescheduling of commercial debts of interested developing countries. Underlying their proposals on indebtedness was a stated need, perceived by the LDC's to be integral to creation of a "New International Economic Order", to reorient the international mechanisms presently dealing with debt reorganization and official development assistance.

In contrast, the United States and the European Community jointly introduced proposals at the CIEC which support the traditional creditor-debtor contractual relationship; require a case-by-case assessment of a developing country's situation on its merits; emphasize the need for preventive and corrective action by the debtor country itself; and largely reserve developed-country consideration of debt relief for cases of imminent or actual default. These proposals embody the U.S. view that debt relief is neither an appropriate instrument for alleviating financing difficulties of developing countries nor an appropriate means of providing official development assistance to the LDC's. The U.S. believes there are other, more effective ways to help developing countries which may be encountering financial difficulties.

Occasionally, a developing country finds it necessary to request rescheduling of its debts. In fiscal year 1976, the United States participated in one multilateral debt rescheduling for Zaire and signed rescheduling agreements with Pakistan and Bangladesh implementing multilateral agreements negotiated in 1974.

Despite the economic stresses of 1976, virtually all the non-oil developing countries were able to obtain financing for their deficits and succeeded in servicing their debts as evidenced by the single case of multilateral rescheduling just cited. Although the outlook for 1977 contains some uncertainties, there is no indication of widespread debt servicing difficulties. Any such difficulties are expected to be confined to a few countries, with the degree of difficulty dependent on the policies which each country may pursue.

II. THE BALANCE OF PAYMENTS AND DEBT OUTLOOK FOR THE NON-OIL LDC'S

1. Overview

The non-oil LDC's sharply reduced their current-account deficits in 1976, from an aggregate level of $38 billion in 1975 to about $29 billion. This decline represents a break of the disturbing events of 1974-75, when current-account deficits rose sharply under the twin shocks of sharply higher oil prices, and of recession in the industrial countries which reduced the demand for LDC exports. The 1976 improvement reflected an expansion of LDC export markets in the recovering OECD countries, as well as slower growth rates in those LDC's which restrained their imports through demand management or direct controls. Prior to the oil price increase, there was some evidence that the aggregate non-oil LDC current-account deficit could decline somewhat in 1977. However, that possibility has been reduced by the decision in December 1976 of the OPEC countries to raise the price of oil for 1977. The size of the non-oil LDC deficit in 1977 will also depend upon the rate of growth of markets in the OECD countries, and the LDCs' determination to make the necessary policy adjustments.

While non-oil LDC real growth rates were lower in the 1974-1975 period than historical averages, growth rates generally remained positive despite negative real growth in the industrial world. In the face of sluggish export demand in 1975 and adverse movements in the terms of trade, LDC's as a group, while reducing import growth, maintained modest GNP growth by undertaking heavy foreign borrowing. In some LDC's, these borrowings were used effectively to ease the adjustment process, as governments implemented corrective policy measures. In other LDC's, adjustment has either proved to be a particularly difficult task or has not received adequate government attention, and recourse to external borrowings has served to maintain living standards in the short run. For some of the poorest LDC's, the possibilities for effecting substantial improvements in current-account positions in the short to medium term are relatively limited.

Despite improvement in the aggregate non-oil LDC current account in 1976, deficits remain large and, when coupled with growing debt service requirements on outstanding debt, will necessitate continued extensive external financing. Even if the 1977 economic situation permits a modest reduction in net borrowings from the private capital market, the rate of accumulation of private debt will remain substantially above historic rates, such that many LDC's will need to work to improve their current-account positions to maintain the confidence of foreign creditors.

This chapter evaluates in broad terms the external financial situation in 1976 of the non-oil LDC's as a group. The discussion is divided into four parts. First, the problem is viewed in a global context, to show the relationship between the current-account position of the OECD countries and that of the non-oil LDC's. The second part focuses on the magnitude of the current-account deficits of the non-oil LDCs for calendar year 1976 and the means by which these deficits might be financed. The third section provides examples of internal policies selected LDC's have undertaken to adjust to balance-of-payments flows and debt service problems. The final section describes some of the uncertainties which lie ahead in 1977 for the balance-of-payments and debt situation of the non-oil LDC's.

2. Definitions, Assumptions, and Forecasting Methodology

Two important definitions used in this chapter must be stated explicitly at the outset. First, non-oil 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, and all Communist countries are excluded from this analysis. Israel, Rhodesia, South Africa and Cuba are excluded, but some oil-exporting countries that are not members of OPEC are included (notably Bahrain, Oman, and Trinidad and Tobago). Second, the current-account deficit is defined as the balance on goods, services, and private transfers. For the purpose of this analysis, grant aid is considered a capital transaction, along with loans, direct investment, etc.

Three approaches were used to estimate the 1976 current-account deficit of the non-oil LDCs. First, the balances of 30 LDC's were estimated individually, and then combined with an estimated figure for the remaining non-oil LDCs. Second, the aggregate balances of OPEC countries, OECD countries, and a group of other countries (including the Sino-Soviet bloc, Israel, South Africa, etc.) were estimated. These balances implied an aggregate balance for non-oil LDC's since global balances theoretically sum to zero. Third, net financial flows to non-OPEC developing countries were examined in detail by source. From these different approaches, it was possible to arrive at a reasonable estimate for the aggregate deficit of non-oil LDC's that was generally consistent with all the hard data available at the time the estimate was made.

3. Global Surpluses and Deficits

The LDC external position is best understood in a global context. In a world where the unilateral pricing of oil ensures the oil-exporting nations a massive current-account surplus, the rest of the world must absorb an equivalent deficit. Although the non-market-economy countries have absorbed some of this deficit, the bulk has been divided between the OECD countries and the non-oil LDC's.

In light of the persistence of the OPEC surplus, the LDC current-account position can improve only to the extent that the industrial countries' aggregate deficit increases. However, in 1975, the current-account position of several major trading nations, especially the United States, improved markedly, largely because of a recession-induced decline in demand for imports, including those from the LDC's. Facing sluggish export demand, the LDC's maintained some import growth by complementing their export receipts with heavy foreign borrowing. The availability of loanable funds, both official and private, enabled many LDC's to cushion the impact of the OECD recession. As Table 1 shows, the end result was that the non-oil LDC's absorbed an extensive share of the deficit required to offset the OPEC surplus.

In 1976, as the OECD economies as a whole recovered, their import demand increased and their aggregate current-account position (excluding official transfers) turned from surplus to deficit. The current account of the United States was a major contributor to that shift, swinging from a surplus of nearly $12 billion in 1975 to a slight deficit in 1976. This permitted the LDC trade and current-account balances to show considerable improvement, as their export markets expanded while lower growth targets in some LDC's reduced their import demand. The aggregate deficit of the oil-importing countries was thus divided more evenly between developed and developing countries, although the LDC's remained the larger absorber.

Table 1

Division of the OPEC Current Account Surplus

Aggregate Current[1] Accounts	1974	($ billions) 1975	1976[2]
OPEC	+72	+41	+43
OECD	-22	+ 7	-10
Non-Oil LDCs[5]	-29	-38	-29
Other[3]	-10	-16	-13
Unexplained Residual	-11[4]	+ 6	+ 9

Source: U.S. Treasury

1. Excludes official transfers.
2. Treasury estimates.
3. Includes the USSR, PRC, Eastern European Bloc, Cuba, Yugoslavia, Israel, Rhodesia and South Africa.
4. A large segment of the residual is accounted for by lags in payments for imported oil.
5. Includes technical cooperation transactions as a service import.

4. 1975/1976 Financing of the LDC Deficit

In 1975 the international financial system showed sufficient flexibility to permit the large deficits of oil-importing LDC's to be financed without undue strain. As Table 2 indicates, net official flows reached $24 billion in 1975 -- more than double their 1973 level -- and financed over 60 percent of the aggregate current-account deficit of $38 billion. Bilateral grants and loans from the OECD nations accounted for $10 billion, multilateral flows (excluding the IMF and OPEC) summed to $6 billion, while OPEC grants and loans totalled $5 billion. A significant development in the international financial system recorded on table 2 is the dramatic increase in net private flows, especially

Table 2

Financing of Non-Oil LDC Deficits, 1973-1976

($ billions)

Deficit on Goods, Services and Private Transfers 2/	1973	1974	1975	1976 1/
	10	29	38	29
EXTERNAL FINANCING:				
Official Flows, net	11	18	24	24
Bilateral DAC grants, loans and credits 3/	7	8	9	10
Bilateral Socialist grants, loans and credits	1	1	1	1
OPEC grants, loans and credits	1	4	5	5
Multilateral grants, loans and credits (excluding IMF and OPEC) 2/	2	4	6	6
IMF and other official credits	0	1	3	2
Private Flows, net	7	14	13	11
Direct investment	4	4	4	4
Private credit (including short-term flows and statistical descrepancies)	3	10	9	7
TOTAL EXTERNAL FINANCING, NET	18	32	37	35
Change in International Reserves	8	3	-1	6
Reserves, year end	28	31	30	35 (Aug.)

1. Treasury Estimates.

2. Includes technical cooperation transactions as a service import, and military transactions that are unreported by recipient countries.

3. Includes technical cooperation grants, military grants and loans and official (but not guaranteed) export credits.

private credits*, which rose from $3 billion in 1973 to about $9 billion by 1975. This increased availability of private financing reflected, in part, the recycling of OPEC's surplus, and the relative weakness of competing demand for funds in the recession-ridden industrial countries.

The figures shown for 1976, while representing estimates based on incomplete data, indicate that the 1974/75 trend toward increased net borrowing on the private credit markets was halted and probably reversed. The aggregate non-oil LDC current-account deficit declined to $29 billion, while official disbursements totaled $24 billion, thereby narrowing the gap to be filled by private capital flows. Part of the increase in official flows came from the International Monetary Fund, whose liberalized Compensatory Financing Facility accounted for more than half of the Fund's net disbursements. The level of net private credit was apparently higher in 1976 than the reduced current-account deficits would suggest because of the sizeable build-up in reserves, which had increased by $5.8 billion as of August.

5. The Adjustment Process

The oil-producing countries have boosted their external revenues far beyond their capacity to absorb imports. They have used their surplus income to purchase financial assets of the oil-importing countries, and this "recycling" of the OPEC surplus has enabled many non-oil LDC's to finance unusually large current-account deficits. Some LDC's also responded to the unfavorable impact which the recession in the industrial countries had on their export earnings by using borrowed funds to sustain development projects and living standards.

While many non-oil LDC's have been able to maintain growth rates by external borrowing, such loans ultimately represent claims held by the creditor countries against the future resources of the debtor. In order for a country to continue to borrow, it must be able to persuade creditors that it will be able to repay those borrowings sometime in the future. Thus, while countries will adjust at differing rates and under various policy choices, the common thrust must be to build up a domestic capital base which will be

*In this discussion the term "private credit" includes bond issues, supplier credits, commercial bank loans, and other short-term flows, as well as any errors and omissions.

capable of producing goods in the future, including a sufficient portion that will earn foreign exchange. It is imperative that this capital base take into account the change in relative prices -- in particular, energy prices. The future flow of production from larger current investments will assure rising income levels as well as permit the actual transfer of real resources to the OPEC countries when their import requirements begin to exceed their oil revenues. Unless such a capital base is built up, a country will have to reduce substantially consumption in the future when it comes time to repay accumulated debts.

Various non-oil LDC's have already undertaken important adjustment measures. For purposes of illustration, brief commentaries will be made on five such LDC's: India, Kenya, Taiwan, Chile, and Colombia. The stable or falling prices resulting from India's successful fight against inflation increased the competitiveness of Indian exports and encouraged a large increase in workers' remittances from the Mid-East. Rapid expansion in the coal industry and the launching of oil exploitation have reduced the growth rate of energy imports, and efforts to spur agricultural output (aided by favorable weather) have reduced the demand for food imports.

Kenya, which suffered from unfavorable weather conditions in 1974/75 as well as declining terms of trade, has adopted a comprehensive adjustment program. Private consumption is being contained by wage and price policies, while special incentives are being introduced to augment exports. Efforts to improve domestic agricultural output include higher producer prices, investment in food processing, improved project preparation for public investment, and higher living standards in the rural areas.

Taiwan early in 1974 adopted a price stabilization program. Many prices, including petroleum, which had been controlled or subsidized were allowed to seek their market levels and, simultaneously, restrictive demand management policies were adopted. The resulting price stability helped Taiwan's export sector remain competitive, which in turn fosters an attractive climate for domestic and foreign investment. The government has used licensing operations to direct capital toward the more efficient industries or sectors.

Chile, which experienced a shortfall in export earnings largely because of the decline in the copper price, has succeeded in sharply increasing its non-traditional exports by adopting measures that include a "crawling peg" exchange-rate regime, and increased availability of export credit. Import demand has fallen as a result of tight monetary and fiscal measures, while import substitution in food production is being stimulated by more favorable producer prices and reforms in land tenure and state agricultural policies.

While the surge in coffee prices eased Colombia's external position, internal reforms have facilitated its adjustment process and kept borrowing needs within moderate bounds. Government finances were rationalized in late 1974, and a major tax reform has generated substantial additional revenues, as have higher public utility tariffs. Inflationary expectations have been reduced by restrictive credit policies and restrained public investment, while the government has acted to keep the windfall coffee revenues from inflating the monetary base. Innovations in capital-market regulations aim to stimulate greater private savings and channel them more efficiently. As the economy recovers, the government is seeking to contain current expenditures to release funds for the development of mineral resources, including petroleum, and for rural investment.

Whichever adjustment policies a government chooses, it may face political difficulties in implementing them. Restraining current consumption may require adoption of an incomes policy that angers wage earners, while tighter credit policies may arouse the displeasure of business. As resources move into more efficient sectors, those sectors that are being de-emphasized are likely to resist. Nevertheless, proper structural reforms should pay off in the long run, as they lay the groundwork for an eventual resumption of steady growth and rising living standards. Political frictions can be reduced in the short run by adopting supplementary measures, such as labor-market policies that cushion the impact of unemployment and reduce its level, and income policies that spread the burden of adjustment more evenly among competing socio-economic groups.

To emphasize the critical importance of adjustment is not to say that developing countries should avoid running balance-of-payments deficits. While adjustments to adverse movements in the terms of trade are necessary, LDC's have historically run modest deficits. The current massive OPEC surplus has made higher deficits unavoidable at this time.

As net importers of capital, the LDC's receive a transfer of real resources which, if efficiently employed, can accelerate growth. The "correct" size of the deficit or level of indebtedness for any particular country depends on the country's economic situation and its development objectives. If a country's policies are viewed externally as being inappropriate or ineffective, then it may not be able to increase its capital inflow and will be forced thereby to reduce its current-account deficit. Alternately, a country might be able to significantly increase its capital inflow and level of external indebtedness if policies are pursued which demonstrate an increase in productive capacity, foreign exchange earnings, and the like.

6. Uncertainties in 1977.

Even at this late date the outlook for current-account positions of the non-oil LDC's as a group is extremely cloudy. Of major importance to the LDC position for 1977 is the size of the oil price increase ultimately effected by OPEC. While the direct effect of an OPEC price increase on the external positions of the non-oil LDC's is relatively small the indirect effect could be substantial. It is estimated that the non-oil LDC's as a group would see a rise in their oil import bill of approximately $1 billion for every 5 percent increase in oil prices. The larger effects are transmitted indirectly through developments in the industrial world: first, higher oil prices result in higher export prices charged by industrial countries and consequently higher overall import bills for the non-oil LDC's. Secondly, to the extent that higher oil prices reduce aggregate demand by the industrial world for non-oil LDC exports, export earnings of the non-oil LDC's would decline. In addition, there is a substantial degree of uncertainty regarding the effects on aggregate demand for non-oil LDC exports that will occur in light of recently undertaken adjustment policies by some of the major industrial countries -- and some of the major non-oil LDC's themselves -- as well as those policies currently under discussion that are likely to be enacted during the course of the coming year.

In a broader perspective, it is important to note that some LDC's have only partially adjusted to the global economic realities of the oil price hike and the recession in the industrial countries of the past two years. As a result such countries may find it necessary to take more complete measures in 1977 to bolster their trade accounts and retain their access to international credit markets. Other LDC's have not taken adequate corrective measures, despite prevailing unfavorable movements in several indicators of potential debt problems. In some cases, such measures could entail a deterioration in growth prospects in the short term. Should these late adjusters find their creditworthiness impaired, they may be unable to finance current-account deficits at existing levels, so that some adjustment on their part will be unavoidable. Even at a late stage, a determined government can implement appropriate measures that maintain foreign confidence. For example, agreement to adhere to a stand-by with the International Monetary Fund can both provide needed foreign exchange in the short run and reassure foreign creditors, who will be encouraged by the government's publicized decision to pursue the sound economic objectives drawn up with Fund cooperation. Ultimately, should a nation momentarily be unable to meet debt service, the impact of this situation can be lessened by the government's giving clear indications of its serious intent to implement the necessary economic reforms.

III. A SUMMARY OF THE DEBT SITUATION OF THE NON-OIL LDC'S AS OF DECEMBER 31, 1974

1. Introduction

The large increase of foreign borrowing by non-oil developing countries in calendar years 1974 and 1975 has intensified the quest for statistical data on developing countries' external debt and their external financial situation. At the present time, data on international debt and lending are compiled from four major sources: The World Bank Debtor Reporting System, the Development Assistance Committee of the Organization for Economic Cooperation and Development, the World Bank Capital Market System, and the Bank for International Settlements.

The data compiled from these sources overlap somewhat with each other, but none of these sources alone provides a comprehensive set of data on developing countries' external debts. 1/

This report utilizes the most recent data provided by the World Bank Debtor Reporting System for calendar year 1974, supplemented by information drawn from the International Monetary Fund's International Financial Statistics on the balance of payments situations of fifteen selected developing countries for 1974 and 1975, which accounted for some two-thirds of the external debt of the non-oil LDC's in 1974. It is felt that presentation of this balance of payments data, which, of course, is different from the World Bank's data on external debt, will, nevertheless, provide the reader with an indication of the magnitude of the change in the external debt position of these countries. This chapter thus serves to complement Chapter II by providing a historical picture of the LDC debt situation at a point in time. This chapter also reviews LDC debt obligations to agencies of the United States government.

Some definitions and explanatory information which underlie the World Bank's data on external debt are as follows:

1/ For a detailed discussion of the composition of these four different sources, see IMF Survey, September 6, 1976.

-- 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.

-- For low and middle-income countries, whose firms invariably borrow funds externally with a guarantee of a public sector institution in their country, the data presented below will reflect a fairly accurate picture of the country's total external debt. For some high-income countries whose firms may borrow funds externally without the benefit of a guarantee of a public sector institution, the external debt figures will underestimate the actual external obligations.

2. Debt Outstanding 1974

At the end of calendar year 1974, the value of the outstanding external public debt of 86 developing countries covered in the debt reporting system of the World Bank was $151 billion. Table 3 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 1971-1974. However, there has been some modest increase in the proportion provided by the private sector and a slight decrease in the proportion provided by official sources.

The $151 billion outstanding debt of LDC's represents an increase of $31 billion, or about 25 percent, compared to the amount outstanding at the end of 1973. This is higher than the 20 percent increase recorded for 1973.

When expressed in nominal terms, the growth of debt outstanding and debt service payments in prior years exaggerates the real economic measure of the debt. Once the nominal value of LDC debt and debt service payments are deflated to adjust for the effects of inflation, LDC debt and debt service are seen to have decreased between 1972 and 1974 in real terms.

It is difficult to construct an index which would unambiguously reflect the complex effect of inflation on the LDC external debt situation. In brief, the effects of inflation are such that one dollar of debt contracted in 1974 will require a smaller volume of exports to discharge the debt than one dollar of debt contracted in 1973. Alternatively, the volume of imports which may be reduced to discharge debts contracted in 1974 will be less than those for nominally equal debts contracted in 1973.

In the absence of a unique measure, it is helpful to utilize an index of export and/or import prices as a deflator as a means to gauge the value of, and changes in, external debt in deflated terms. Table 4, which presents the debt data in both nominal and deflated terms, shows that by using the export and/or the import price index, as a deflator the adjusted value of the external debt of the LDC's and their debt service payments decreased between 1972 and 1974.

Table 3

External Public Debt of 86 Developing Countries as of December 31, 1974 (in $ millions)

	Amount	Percent of Total
Bilateral Official	$ 66.8	44.1
Multilateral	30.2	20.0
Private Lenders	54.4	35.9
Suppliers	(16.2)	(10.7)
Banks	(28.7)	(19.0)
Other	(9.5)	(6.3)
	$151.4	100.0

Note: Comprises undisbursed and disbursed debt outstanding over one-year original maturity. Totals may not add due to the rounding.

Source: World Bank

Table 4

External Debt and Debt Service Payments of Developing Countries for 1972-1974 - Deflated by Export and Import Price Indices

(in $ billions)

	1972	1973	1974	Change 1974/ 1973
Total External Debt				
Nominal Values	99.5	118.5	150.6	32.1
Adjusted by Export Price Index	99.5	99.3	89.7	- .6
Adjusted by Import Price Index	99.5	96.9	90.6	- 6.3
Debt Service Payments				
Nominal Values	8.5	11.0	13.2	3.2
Adjusted by Export Price Index	8.5	8.3	7.9	- .4
Adjusted by Import Price Index	8.5	8.9	7.9	- 1.0

Source: World Bank Annual Report and World Debt Tables

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 1974, fifteen non-oil LDC's accounted for over one-half of total LDC debt. The first five of these countries -- India, Brazil, Mexico, Pakistan and South Korea -- accounted for about $48 billion, or 31 percent, of total LDC debt and 38 percent of the debt of non-oil LDC's. The debt of Israel, Argentina,Chile, Turkey and Egypt totalled some $22 billion, 14 percent of total LDC debt and 17 percent of the debt of the non-oil LDC's. A third group -- Peru, the Republic of China, Colombia, Zaire and the Philippines -- accounted for 8 percent of the total debt and 11 percent of the debt of the non-oil LDC's.

Tables 5 and 6 provide further information on the distribution of the debt among countries classified according to income level and changes in the groupings between calendar years 1973 and 1974. While there were significant increases in the nominal amounts of debt outstanding for each category of countries, there was only a slight increase (about 1 percentage point) in the proportion accounted for by high and middle-income countries, a modest decrease (two and one-half percentage points) in the proportion accounted for by lower-income countries.

Table 5

Summary: Outstanding External Debt of 86 Developing Countries in 1973 and 1974 (In \$ millions unless otherwise noted)

	1973	1974	Change
Oil Producing Countries	23.3	25.9	2.6
Percent of total	(19.7)	(17.2)	(8.0)
High Income Countries	52.6	68.8	16.1
Percent of total	(44.4)	(45.7)	(50.3)
Middle Income Countries	15.4	21.3	5.9
Percent of total	(13.0)	(14.2)	(18.4)
Lower Income Countries	27.0	34.5	7.5
Percent of total	(22.9)	(22.9)	(23.3)
Overall Total	118.3	150.6	32.1

Note: Totals may not add due to rounding.

Source: World Bank

The external public debt of those countries designated as "Most Seriously Affected" (MSA's) by the United Nations was almost \$38 billion as of December 31, 1974. This amount represented an increase of \$7.8 billion, or 26 percent, compared to the \$30 billion of MSA debt outstanding at the end of 1973. Within the total MSA debt for 1974, three countries -- India (\$14.2 billion), Pakistan (\$6.2 billion), and Egypt (\$3.1 billion) -- accounted for 63 percent of the total. About 90 percent of the increase in debt outstanding between 1973 and 1974 was provided by bilateral official and multilateral institutions. These loans usually carry low interest rates, long repayment periods, and grace periods which, in some cases, may extend up to ten years. Thus, soft-term loans undertaken in recent years by the MSA's and other low-income countries will not represent a major claim on foreign exchange earnings of these countries for several years to come.

4. Estimates of External Debt of Non-Oil LDC's for 1975 and Beyond

As indicated at the outset of this chapter, calendar year 1974 is the latest date for which complete data are available on LDC's external debt. It is possible, however, to derive an indication of the magnitude of the change in a country's external debt position since 1974 by use of balance of payments data for 1975 which, in many instances, are more readily available than data on external debt.

Table 6

OUTSTANDING EXTERNAL PUBLIC DEBT OF 86 DEVELOPING COUNTRIES
1973 AND 1974

(In $ Million)

Oil Producing Countries	1973	1974	Change
Indonesia	6,616.4	8,696.0	2,079.6
Iran	7,047.0	6,604.4	-442.6
Algeria	4,995.0	6,039.5	1,044.1
Venezuela	1,901.2	1,856.3	-44.9
Nigeria	1,101.2	1,078.5	-22.7
Iraq	736.8	670.0	66.8
Ecuador	549.0	532.5	-16.5
Gabon	393.1	439.1	46.0
Total Oil Producing Countries	23,340.1	25,916.3	2,576.2
Percent of Total	19.7	17.2	8.0

Table 6 (cont'd)

OUTSTANDING EXTERNAL PUBLIC DEBT OF 86 DEVELOPING COUNTRIES
1973 AND 1974

(In $ Million)

High Income Countries	1973	1974	Change
Brazil	9,296.7	11,984.3	2,687.6
Mexico	7,031.1	9,766.2	2,735.1
Israel	4,776.1	5,894.8	1,128.7
Argentina	3,599.1	4,863.7	1,264.6
Chile	3,327.0	4,459.6	1,132.6
Turkey	3,778.1	4,306.2	528.1
Yugoslavia	2,443.0	3,459.3	1,016.3
Peru	2,151.2	2,972.1	820.9
Spain	1,980.3	2,940.3	960.0
Colombia	2,721.8	2,750.3	28.5
Greece	2,250.1	2,733.0	482.9
China	1,813.2	2,607.9	794.7
Malaysia	1,119.6	2,189.1	1,069.5
Tunisia	1,265.8	1,443.8	178.0
Zambia	966.9	1,188.7	221.8
Jamaica	458.9	650.0	191.1
Panama	669.3	644.1	-25.2
Nicaragua	487.1	641.1	154.0
Singapore	525.7	639.0	113.3
Dominican Republic	430.4	623.3	192.9
Uruguay	453.2	615.6	162.4
Costa Rica	340.9	478.8	137.9
Guyana	228.7	322.7	94.0
Trinidad and Tobago	182.7	227.5	44.8
Guatemala	192.3	209.6	17.3
Cyprus	79.1	100.7	21.6
Fiji Islands	64.7	66.3	1.6
Malta	22.5	32.9	10.4
Total High Income	52,645.5	68,810.9	16,165.4
Percent of Total	44.4	45.7	50.3

Table 6 (cont'd)

Middle Income Countries	1973	1974	Change
Republic Korea	$4,413.1	$6,147.3	$1,734.2
Egypt	2,325.4	3.119.5	794.1
Philippines	1,376.2	2,002.2	626.0
Morocco	1,244.9	1,902.1	657.2
Ivory Coast	882.9	1,213.2	330.3
Thailand	750.0	1,122.6	372.6
Bolivia	770.5	894.6	124.1
Syria	435.5	769.1	333.6
Ghana	666.8	684.4	17.6
Cameroon	418.0	570.1	152.1
Jordan	323.0	546.0	223.0
People Republic of Congo	355.5	499.1	143.6
Senegal	347.2	408.1	60.9
El Salvador	193.6	309.8	116.2
Paraguay	212.3	309.3	97.0
Honduras	207.2	273.9	66.7
Liberia	196.0	211.6	15.6
Botswana	162.3	179.0	16.7
Mauritius	99.5	121.7	22.2
Swaziland	34.7	57.8	23.1
Total Middle Income	$15,414.6	$21,341.4	$5,926.8
Percent of Total	13.0	14.2	18.4

Table 6 (cont'd)

Lower Income Countries	1973	1974	Change
India	$12,365.8	$14,207.5	$1,841.7
Pakistan	5,151.2	6,230.0	1,078.8
Zaire	1,519.0	2,562.8	1,043.8
Bangladesh	835.5	1,674.9	839.4
Afghanistan	973.4	1,596.3	622.9
Tanzania	793.8	1,096.3	302.5
Sudan	550.1	1,051.2	501.1
Sri Lanka	636.0	816.0	180.0
Kenya	596.1	733.9	137.8
Ethiopia	473.6	566.0	128.4
Burma	417.4	455.4	38.0
Somalia	267.7	377.6	109.9
East African Comm.	305.1	359.2	54.1
Mauritania	92.0	336.1	244.1
Mali	399.3	335.1	-64.2
Malawi	267.1	320.6	53.5
Viet Nam	172.7	291.5	118.8
Uganda	119.5	147.1	27.6
Dahomey	137.5	232.8	95.3
Malagasy Republic	198.9	232.2	33.3
Togo	163.2	190.8	27.6
Upper Volta	119.5	147.1	27.6
Sierra Leone	122.6	146.3	23.7
Niger	116.7	107.8	-8.9
Central African Republic	71.8	72.0	.2
Chad	55.2	71.4	16.2
Rwanda	43.1	57.1	14.0
Gambia	12.7	22.8	10.1
Burundi	8.6	21.3	12.7
Lesotho	12.8	16.7	3.9
Total	$26,997.9	$34,329.5	$7,513.9
Percent of Total	22.8	22.8	23.4
Overall Total	118,398.1	150,398.1	32,182.3

Source: World Bank

Table 7 below sets forth the aggregate current account balance and major sources of financing for the fifteen non-oil LDC's cited earlier in this chapter which accounted for some two-thirds of the non-oil LDC debt in calendar year 1974. This group of countries also accounted for roughly two-thirds of the combined current account deficit of all non-oil LDC's in 1974 and 1975 and is fairly representative of the different income levels of the non-oil LDC's.

Table 7

Current Account Deficits and Major Sources of Financing for Selected Non-oil LDC's, 1974-1975 (in $ billions)

	1974	1975	Change
Current Account Balance	-20.8	-26.3	-5.5
Financed by:			
Government Unrequited Transfers (net)	2.0	2.0	-
Net Direct Investment	2.3	2.6	.3
Net Change in Long-Term Liabilities	11.3	15.7	4.4
IMF Credit and Other Liabilities	.2	2.6	2.4
Decrease in Reserves	1.7	2.0	.3
Sub-Total	17.5	24.9	7.4
Residual	3.3	1.4	-1.9
Total	20.8	26.3	5.5

Source: IMF - International Financial Statistics

As indicated in the table, the combined current account deficit of these 15 non-oil LDC's increased from about $21 billion in 1974 to $26 billion in 1975. Non-debt items -- government net transfers and direct investment -- did not change appreciably in financing the combined deficit of 1975, but the use of debt-related items -- net long-term credit undertaken by private and public sector entities in these countries, borrowing from the IMF, and contraction of other liabilities which totalled some $18 billion -- increased by nearly $7 billion in 1975. Drawing on reserves in

1975 was about the same as in 1974, while "residual items" -- short-term capital and errors and omissions -- played a smaller role in accounting for the financing of the deficit in 1975 than in 1974.

For calendar year 1976, it is expected that the combined current account deficit of these 15 countries will have declined significantly, in accordance with the estimates for all non-oil LDC's provided in Chapter II. It is unlikely, however, that debt-related financing items will show a decrease by an amount equivalent to the decline in the current account deficit, since many countries appear to have utilized new long-term credits as a basis for rebuilding their reserves. Indeed, for the first half of calendar year 1976, preliminary data compiled by the International Monetary Fund indicate that these fifteen non-oil LDC's increased their reserves by some $3 billion.

5. Basic Causes of Debt Service Problems

The definition of "debt service problem" is unique to a particular country at a particular time. Rule-of-thumb indicators, such as debt-service ratios, are misused if a country is classified on the basis of these indicators as having or not having a debt-servicing problem. A country's ability to service debt depends on the pace and makeup of its economy and the appropriateness of the policies it is pursuing, including policies to deal with fluctuations in foreign exchange earnings. The debt-service ratio of a country struggling to service its debt may be the same as the ratio for another country which manages its debt-service obligations without difficulty. A country facing "debt service problems", then, is one whose combined economic situation and level of indebtedness make it difficult for the country to service its debt; not a country whose debt-service ratio is *per se* high.

The causes of debt servicing problems do not lend themselves easily to generalizations. Debt service problems may be caused by deficiencies in the management of monetary, fiscal and balance of payments policies including external debt management. Some debt servicing problems arise from extenuating circumstances that can complicate economic management, e.g., changes in government, economic effects of war, impact of floods, droughts and other climatic disasters and sudden large changes in the terms of trade due to external events that have sudden adverse effects on the ability to earn foreign exchange.

The immediate cause of debt servicing difficulties is usually an acute lack of foreign exchange with which to meet contracted external payments due to a general balance-of-payments problem. Such a situation may be due to a number of factors, some of which are within the immediate control of debtor governments while others are not. In any case, these difficulties would probably exist even without the need to pay debt service.

In the past, balance-of- payments difficulties which could make a debtor country susceptible to debt service problems have often arisen from excessive domestic demand associated with relatively large public sector spending and inadequate domestic savings. As a result, sizeable budget deficits develop which require an unusually large creation of domestic credit that increases inflationary pressures, increases imports, reduces export competitiveness and promotes capital flight. Over time, this process tends to accelerate as the exchange rate becomes more over-valued and as public confidence in the country's ability to manage the balance-of-payments declines. Some countries begin to borrow foreign commercial funds on harder terms -- higher interest rates, shorter maturities and other more restrictive conditions -- to cover payments for essential imports. Consequently, less rigorous attention may be given to the planning, appraisal and implementation of investment projects. This, of course, increases near term debt service payments and tends to intensify problems due to the shortage of foreign exchange.

Incurring external debt should not lead to debt service problems if good use has been made of the loans and appropriate debt management policies are followed. The accumulation of external debt should reflect creation of productive capital that provides a flow of income at least equal to the external debt service.

The current global economic situation has, of course, greatly complicated the task of efficient debt management and brought into play other factors which may increase a debtor country's short-term balance-of-payments financing situation.

6. Indicators of Debt Service Problems

There is no one statistical indicator that can predict accurately whether a country will encounter external debt servicing problems at a certain point in time. A debt service problem or inability to provide foreign exchange to make contracted external payments is part of a general shortage of foreign exchange of the debtor country, since debt service payments are only one of many types of foreign exchange transactions in the balance of payments. Moreover, foreign exchange availability is not limited to such earnings but includes a country's international reserves and its ability to borrow from official assistance agencies, foreign commercial banks and various facilities of the International Monetary Fund. As a result, indicators have to cover a broad range of debt, economic and financial variables. In addition, political considerations or other relevant events may have significant effects on debt servicing capacity. As a result, informed judgments are essential to an overall assessment of a debtor country's capacity to service external debt.

The Debt Service Ratio

One indicator which is used by some analysts to measure debt service capacity is the percentage of annual external debt service on public sector debt to annual export earnings. The value of this indicator lies in its ability to reflect partially the short-run rigidity in a country's balance-of-payments situation. The higher the ratio, the greater is the proportion of export earnings which are utilized to discharge debt service obligations. The debt service ratio, however, is not a useful indicator of a country's ability to service its debt over the medium term, which depends upon factors such as the rate and productivity of investment and its ability to achieve a sustained rate of growth in current foreign exchange earnings. Nor is the ratio very helpful even for a very short-term assessment in the absence of information on current account or overall balance-of-payments developments, the level and rate of change in external reserves, etc.

Further, the weakness of the debt service ratio as a tool in inter-country comparisons is also illustrated by the example of two countries with equal debt service ratios but different variabilities of export earnings. Although greater risk of debt servicing is associated with the country whose export earnings are more highly variable, this fact is not revealed by the equal debt service ratio.

One other shortcoming of publicized debt service ratios is that they do not include private borrowings. Data on debt service payments arising from private sector borrowing are not easily attainable, and the absence of such information for higher income developing countries seriously understates the numerical and analytical value of this ratio.

Maturity Structure and Grant Element

The maturity structure of a country's external debt may also be used to help form judgments of a country's ability to service its debt over the medium term. The average maturity of a country's debt is represented by the ratio of annual external debt payments to outstanding external debt. A low ratio suggests longer term external liabilities and is generally associated with a favorable maturity structure, while a high ratio suggests that relatively large debt service payments fall due in the near term. One variation of this ratio frequently used by analysts is to construct a series of time profile ratios of a country's external debt. Such profiles consist of annual debt service payments taken over a period of time -- 2, 5, or 10 years, to debt outstanding as of a given year -- usually the latest year for which debt data are available. In its recent publication, External Public Debt of LDCs, the World Bank notes that, between 1969 and 1974 the proportion of service payments of all developing countries falling due in the following five-year periods increased somewhat from 48 percent to 52 percent, reflecting in large part the increase in lending extended on short term by private sources. Within this aggregate, however, the 5-year time profile ratio on loans provided by international organizations decreased between 1969-1974, reflecting the growing importance of the soft loans of the World Bank Group lending of IDA funds.

Information on grant equivalents and grant elements, two measures which reflect the concessional element of a loan, may also be helpful in appraising a country's debt structure and debt servicing capabilities. Countries contracting debts with high grant equivalents and high grant elements generally will not require a use of foreign exchange to discharge the loan over the short-to-medium term period since high grant element loans usually carry grace periods which may extend up to ten years. Countries contracting loans with low grant elements, however, are more likely to face a claim on foreign exchange over the short-to-medium term.

According to data provided by the World Bank, the average grant element on loans committed in 1974 remained highest for the low-income countries, 46 percent, and lowest for the high-income countries, 15 percent.

7. The U.S. Government Stake

As of June 30, 1976, the less developed countries owed the United States government, their largest creditor, a total of over $29 billion. An analysis of LDC debt by geographical region shows that South and East Asia is the largest LDC debtor to the U.S. with $11.8 billion. Latin America is second with a debt of $7.5 billion, and the Near East is third with a $6.1 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. Table 9 shows the outstanding indebtedness of the 13 members of OPEC to the U.S. government as of June 30, 1975, and June 30, 1976. The indebtedness of Indonesia and Iran, by far the largest debtors, together accounted for 77 percent of OPEC debt owed to the United States.

Table 8

Outstanding Long-Term Principal Indebtedness of Developing Countries on U.S. Government Credits by Major Program (as of June 30, 1976)

Program	Amount (in $ millions or equivalent)
Eximbank	$ 6,743
Foreign Assistance and related acts	15,840
Agricultural Trade Development & Assistance	5,844
CCC	557
Lend-Lease, surplus property, other war accounts	220
Other credits	122
Total	$29,326

Source: Compiled by: U.S. Department of Treasury, from information made available by operating agencies.

Table 9

OUTSTANDING INDEBTEDNESS OF OPEC COUNTRIES ON U.S. GOVERNMENT LONG TERM CREDITS

($ Million)

	6/30/75	6/30/76
Algeria	218	272
Ecuador	117	117
Gabon	8	9
Indonesia	1,250	1,437
Iran	1,006	891
Iraq	9	7
Kuwait	0	0
Libya	0	0
Nigeria	79	103
Qatar	0	0
Saudi Arabia	21	11
United Aran Emirates	0	0
Venezuela	205	171
TOTAL	2,913	3,018

Sources: Complied by U.S. Departments of Treasury and Commerce, Bureau of Economic Analysis, from information made available by operating agencies.

IV. INTERNATIONAL CONSIDERATION OF LDC DEBT, U.S. POLICY AND DEBT RESCHEDULINGS IN FY 1976

1. Introduction

As a result of economic difficulties arising largely from oil-price increases and the worldwide recession of 1974 and 1975, many developing countries intensified their demands for direct positive measures to be undertaken by the developed countries to deal with the LDC debt situation. During FY 1976, major consideration was given to the debt situation of non-oil LDC's by both the Fourth United Nations Conference on Trade and Development (UNCTAD IV) and the Conference on International Economic Cooperation (CIEC).

2. UNCTAD IV

Prior to UNCTAD IV which convened in May 1976, the developing countries agreed on a document known as the Manila Declaration and Plan of Action. On the question of debt, the Plan called for outright cancellation of debts owed government lenders by the least developed, developing land-locked, and developing island countries, in addition to debt relief for other "most seriously affected" developing countries seeking such relief; new program lending by international development finance institutions to each developing country in an amount no less than its debt service payments to these institutions and consolidation and rescheduling of the commercial debts of interested developing countries. These measures would be put into effect by a conference of creditor and debtor countries.

The debt proposals contained in the Manila Declaration and Plan of Action were offered by the developing countries at UNCTAD IV for consideration and agreement. Developed countries at the Conference rejected the LDC demands for generalized debt relief, but addressed the "debt problem" in the broader context of the overall economic and financial situation of a developing country which was, in their view, the whole of the issue to be considered. Specifically regarding treatment of actual or imminent default of debt ("acute debt crisis") by developing countries, the developed countries suggested that ways be found to improve the traditional case-by-case approach.

No substantive merging of views resulted from debating these two sets of proposals on debt. Instead, countries at UNCTAD IV agreed to a procedural resolution resulting in a continuation of the discussion in other international bodies. In the U.S. view, the appropriate international forum for the debt issue is the Conference on International Economic Cooperation.

3. CIEC

Subsequent to UNCTAD IV, substantive international work on debt has been limited to the Conference on International Economic Cooperation. This body, a temporary forum for North/South issues established in December 1975 and due to conclude early in 1977, has been debating the issue of LDC indebtedness in two of its four commissions, the Development Commission and the Financial Affairs Commission. Proposals on debt have been offered by the developing and OPEC countries (G-19), and jointly by the U.S. and European Communities (EC).

At CIEC, the G-19 put forward proposals which revert to the wide-ranging, extreme positions of the Manila Plan. The G-19 proposals call for generalized debt relief in the form of immediate forgiveness of the bilateral official debts of certain major groups of developing countries, as well as debt relief for any other developing country which seeks relief. In addition, the proposals call for consolidation and rescheduling, over a period of at least 25 years, of the commercial debts of interested developing countries. In setting forth their philosophy on the subject of indebtedness, the G-19 cite the adverse effects recent economic events have had on development strategies, and an "obvious need to reorient" the international mechanisms presently existing to deal with debt reorganization and official development assistance. They state that this reorientation is "integral to the creation of a 'New International Economic Order'", a key objective of the LDC's and one which is entirely unacceptable to the U.S. The principles, procedures, and guidelines the G-19 propose in order to bring about this reorientation would include:

-- no debtor-country responsibility for taking measures to prevent or correct debt-servicing or other financial problems;

-- an a priori commitment by donor countries to "contribute the necessary resources" whenever a developing country requests relief; and in doubt developing-country creditworthiness, penalizing those LDC's which have worked hard to establish a good credit standing and need to maintain their access to capital markets to finance part of their development programs. Indeed, the U.S. believes this view may be shared by such countries.

In dealing with matters of developing-country indebtedness, the U.S. encourages debtor countries to undertake economic and financial policies necessary for healthy growth which will minimize the need for, and incidence of, debt relief operations. When presented with a proposal for debt reorganization, the United States evaluates the merits of the individual case, predicated on basic adherence to scheduled terms of credit payment and on the belief that debt rescheduling can only be viewed as a temporary vehicle to allow an individual country to institute the policy changes necessary to restore the viability of its economy.

5. Debt Reschedulings in Fiscal 1976

The developing countries have, as a general rule, had an excellent record in honoring debt obligations. Despite the economic and financial upheavals of the past two years, debt rescheduling has been the exception rather than the rule and when used has, in any event, helped to ensure ultimate repayment by debtor countries. During fiscal year 1976, the United States participated in only one multilateral debt rescheduling meeting, for Zaire, and signed rescheduling agreements with Pakistan and Bangladesh implementing multilateral agreements negotiated in 1974.

Zaire

In recent years, Zaire's economic situation has been characterized by rapid price increases, substantial balance of payments deficits and a slowdown in the rate of economic growth. Since mid-1974, the economy of Zaire has been subject to a number of external and internal pressures which led to the development of a critical situation in 1975 and a subsequent need for debt rescheduling in 1976. Externally, the sharp decline in the world market price of copper (Zaire's major export) and the continuing increase of import prices led to a large trade deficit. Additional problems arose because of the closing of the Benguela railroad in Angola which is an important route for Zaire's trade. On the domestic side, expansionary fiscal and credit policies increased aggregate demand at unsustainable rates contributing to increased imports and an enlarged current account deficit; and, with rapidly growing expenditures, government budget deficits further aggravated inflationary pressures.

In response to the inability of the Government of Zaire to meet its debt obligations, the Paris Club of creditor countries concluded an ad referendum debt rescheduling agreement in June 1976. Under the terms of this agreement, principal and interest falling due from January 1, 1975, to June 30, 1976, and not yet settled, as well as principal payments falling due during the second half of 1976, are to be rescheduled. Bilateral agreements between Zaire and the Paris Club member countries are to be negotiated to implement formally this rescheduling agreement.

Pakistan and Bangladesh

United States debt negotiations with Pakistan and Bangladesh were in response to the unique circumstances stemming from the 1971 war and the independence of Bangladesh. After the conclusion of hostilities, Pakistan insisted that debts arising from programs of primary benefit to Bangladesh should be assumed by Bangladesh. Bangladesh affirmed its intention to assume responsibility for a portion of the external debt of the formerly united Pakistan, but only in the context of an overall financial settlement. In order to facilitate a final settlement, the Aid-to-Pakistan Consortium agreed to short-term debt reschedulings in 1972 and 1973. United States implementation of the 1973 understanding, under which the United States agreed to reschedule approximately $23 million in debt falling due between July 1973 and June 1974, is formalized in the present debt agreement.

In the June 1974 Memorandum of Understanding, the creditor countries agreed to provide debt relief to Pakistan in the amount of $650 million, to be provided over the following four or five years. The creditor countries also agreed that the terms of this debt relief would include a grant element of no less than 62 percent. The bilateral agreement between the United States and Pakistan became effective in April 1976 and provides for the rescheduling of approximately $203 million in debt service falling due during the period from fiscal year 1975 to fiscal year 1979 (see Appendix).

V. EFFECT OF DEBT RESCHEDULING ON THE EXTENSION OF NEW CREDITS

The rescheduling of debt has generally not impaired the ability of the debtor country to obtain new credit. One of the attractions of the rescheduling operation for the borrower is that it makes it possible to avoid the denial or reduction of access to new credit that would take place in the event of a simple default. Many international lenders follow the policy of withholding new loans to countries that are in default on existing international loans. This helps induce the borrowers to enter into agreements to repay those loans according to a new schedule mutually agreed between borrowers and lenders. The alternative would be a drying up of needed foreign credit.

This inducement would be less attractive if the lenders were to follow the policy of withholding new credit after the rescheduling agreement was worked out. As long as such agreements have provided for policy reforms in the debtor country designed to overcome the problems that led to the inability to service existing debt on schedule, lenders are usually willing to resume lending.

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, because of legal prohibitions, no credit has been extended because of a default by the debtor country (e.g., see Sec. 620q of the Foreign Assistance Act of 1961, as amended). 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 which the debtor country might be unable to service.

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, as amended, as well as Public Law 480.

Prior to passage of the Foreign Assistance Act of 1973, repayment on AID credits were authorized to be made available for the extension of new credits. A debt rescheduling reduced the reflow of funds that would be available for new loans and, therefore, had a direct effect on the level of these loans. This provision was changed by the 1973 amendment to Section 203 of the Foreign Assistance Act of 1961.

The amendment provided that not more than 50 percent of dollar receipts scheduled to be paid during each of the 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 remainder of dollar receipts went to Treasury's miscellaneous receipts. The effect of this provision was to remove the direct effect of debt rescheduling on funds available for loans.

Section 203 of the Foreign Assistance Act of 1961 was again amended in December 1974 by the addition of a provision that after July 1, 1975, none of the dollar receipts from loans made under Part I of the Act or predecessor foreign assistance legislation would be available for making new loans. All such receipts are to be deposited to Treasury's miscellaneous receipts. 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 PL 480 is affected by debt reschedulings. Section 102 of PL 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.

The same is true in the case of the Export-Import Bank. 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), debt reschedulings may reduce the ability of the Bank to make new loans.

VI. A SUMMARY OF NET AID FLOWS TO COUNTRIES RECEIVING MAJOR DEBT RELIEF

Comprehensive data on U.S. foreign assistance and other credits to all foreign countries from 1945 to 1975 can be found in the 1976 Annual Report to the National Advisory Council on International Monetary and Financial Policies in Tables B-1 through B-12. Table 10 below is compiled from balance of payments information and shows the net flow of U.S. foreign assistance and credits to two major countries that rescheduled in calendar year 1975: Chile and India. These flows are categorized into grants, credits, and "other". The amount of debt reorganization or debt rescheduling for each of these countries is also noted.

Although the primary purpose of debt relief was not related to the provision of new assistance, debt relief in effect added $23 million of assistance, and credits to Chile and $22 million to India. After other new assistance, credits, and recoveries from older assistance are taken into account, total U.S. government net assistance and credits to Chile was $128 million and to India was $243 million. If receipts of interest are offset against the net assistance totals, the net flow of aid to Chile and India was $70 million and $170 million, respectively.

Table 10

Summary of major U.S. Government net foreign assistance to Chile, and India
Calendar year 1975, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India	
	Total	Of Which: Debt reorganization	Total	Of Which: Debt reorganization
NET TOTAL, ALL PROGRAMS (excluding interest collections)	127,992	23,242	243,044	21,521
Grants				
Total grants	11,078	---	169,517	---
Under Foreign Assistance Act and related programs	986	---	2,723	---
Under authorizations for farm products disposals:				
From foreign currencies under the Agricultural Trade Development and Assistance Act	---	---	2,547	---
For famine, other urgent, and extraordinary relief, for economic development, and through private welfare agencies	9,606	---	163,754	---
Peace Corps	486	---	493	---
Credits				
Net	116,913	23,242	78,710	21,521
Gross (new)	251,240	92,847	189,501	45,136
Under Export-Import Bank Act	57,482	52,587	19,036	---
Under Foreign Assistance Act and related programs:				
Country program loans	16,967	16,699	60,350	45,000
Financing of military purchases	9,669	---	1,369	---
Social Progress Trust Fund	2,680	---	---	---
Investment incentive credits	55,534	8,937	---	---
Under Agricultural Trade Development and Assistance Act:				
Currency loans to foreign governments	1,491	1,491	---	---
Currency loans to private enterprises	---	---	136	136
Long-term dollar credits	97,943	3,659	108,610	---
Under Commodity Credit Corporation Charter Act	9,474	9,474	---	---

Table 10 (cont'd.)

Summary of major U.S. Government net foreign assistance to Chile, and India
Calendar year 1975, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India	
	Total	Of Which: Debt reorganization	Total	Of Which: Debt reorganization
Less principal collections	134,327	69,605	110,791	23,615
Under Export-Import Bank Act	76,335	47,026	35,082	---
Under Foreign Assistance Act and related programs:				
Country programs loans	17,544	10,730	61,026	23,615
Financing of military purchases	4,569	---	2,003	---
Social Progress Trust Fund	2,417	---	---	---
Investment incentive credits	8,607	---	---	---
Under Agricultural Trade Development and Assistance Act:				
Currency loans to foreign governments	1,246	966	---	---
Currency loans to private enterprises	---	---	9,270	---
Long-term dollar credit sales	6,785	3,040	---	---
Other credits	16,824	7,843	3,410	---
Under Commodity Credit Corporation Charter Act	16,820	7,843	---	---
Miscellaneous	4	---	3,410	---
Other Assistance (through Net Accumulation of Foreign Currency Claims)				
Net	1	---	-5,183	---
Farm products sales: (Under Commodity Credit Corporation Charter Act)	4	---	156	---
From 2d-stage operation (under Agricultural Trade Development and Assistance Act)	2,610	---	14,584	---
Less currencies disbursed for grants, credits, and other uses	2,613	---	19,923	---
Under Mutual Security Acts	---	---	110	---
For economic grants and credits in recipient's currency	---	---	110	---

Table 10 (cont'd.)

Summary of major U.S. Government net foreign assistance to Chile, and India
Calendar year 1975, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India	
	Total	Of Which: Debt reorganization	Total	Of Which: Debt reorganization
Under Agricultural Trade Development and Assistance Act	2,609	---	19,657	---
For economic grants and credits in recipient's currency	---	---	2,547	---
Other	2,609	---	17,110	---
Under Commodity Credit Corporation Charter Act:				
Other than for grants and credits	4	---	156	---

Table 10 (cont'd.)

Summary of major U.S. Government net foreign assistance to Chile, and India
Calendar year 1975, gross and returned, by type and program
(In thousands of dollars and equivalents)

	Chile		India	
	Total	Of Which: Debt reorganization	Total	Of Which: Debt reorganization
MEMORANDUM: Interest Collections				
Total, interest collections (-)	45,795	14,305	72,848	21,521
Under Export-Import Bank Act	23,094	5,561	8,462	---
Under Foreign Assistance Act and related programs:				
Country program loans	10,313	5,969	49,454	21,385
Financing of military purchases	1,372	---	87	---
Social Porgress Trust Fund	953	---	---	---
Investment incentive credits	3,906	---	---	---
Under Agricultural Trade Development and Assistance Act:				
Currency loans to foreign governments	724	525	---	---
Currency loans to private enterprises	---	---	5,450	136
Long-term dollar credit sales	1,001	619	8,270	---
Other credits	4,432	1,631	1,125	---
Under Atomic Energy Act	---	---	1,125	---
Under Commodity Credit Corporation Charter Act	4,432	1,631	---	---
MEMORANDUM TOTAL: Investment guaranty payments OPIC				
Guaranties paid	43,636	---	49	---
Recovery on guaranties	55,534	8,937	49	---
MEMORANDUM TOTAL: Net assistance, interest, collections, and investment guaranty transactions	70,299	---	170,196	---

NOTE: Excludes military grant assistance. For other important qualifications affecting this table and for definitions of terms, see the explantory note to the corresponding tables in the statistical appendix to the Annual Reports 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.

APPENDIX

DEPARTMENT OF STATE

Washington, D.C. 20520

March 22, 1976

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 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 agreements with Pakistan and Bangladesh. The agreement with Pakistan will reschedule approximately $203 million in debt service falling due over the five year FY 1975-79 period. The United States will also reschedule $85 million in debt service obligations being assumed by Bangladesh. Bangladesh will also assume responsibility for servicing $2.6 million in Export-Import Bank loans which will not be rescheduled. The agreement implements an understanding reached with Pakistan by the World Bank, in its capacity as Chairman of the Pakistan Consortium, on June 28, 1974. Chairman Morgan of the International Relations Committee was informed of these debt rescheduling negotiations in letters dated August 14, 1974 and June 27, 1974.

As noted in our letters to Chairman Morgan, United States negotiations with Pakistan and Bangladesh were in response to unique circumstances that arose as a result of the 1971 war and the independence of Bangladesh. After the war Pakistan insisted that debts should be paid by Bangladesh. For its part, Bangladesh affirmed its intention to assume the international responsibilities incumbent upon a sovereign state, including a portion of the external debt of the formerly united Pakistan, but only within the context of an overall financial settlement.

The Honorable
Carl Albert, Speaker,
House of Representatives.

The creditors of the Aid-to-Pakistan Consortium agreed to work towards developing a procedure to overcome the impasse with the aim of avoiding a default on any portion of the total debt. The creditors also sought to frame any agreement in the context of Pakistan's unique situation so as to avoid setting an undesirable precedent for other countries. In order to facilitate a final settlement which would achieve creditor objectives, the Aid-to-Pakistan Consortium agreed to short-term debt reschedulings in 1972 and 1973. United States implementation of the 1973 understanding, under which the United States agreed to reschedule approximately $23 million in debt falling due between July 1, 1973 and June 30, 1974, is also formalized in the current agreement.

In the June 28, 1974, Memorandum of Understanding the creditor countries agreed to provide debt relief to Pakistan in the amount of $650 million, to be provided over the four years beginning July 1, 1974. The creditors also agreed that the terms of relief would be at a grant element of no less than 62 percent. Pakistan has agreed to continue payments upon all debt due to creditors in the participating countries. The United States share of relief to be provided to Pakistan over the four years is about $196 million. The actual amount the United States has decided to reschedule during this period is $186 million. The United States will, however, provide compensating relief in a fifth year, an option permitted in the Memorandum of Understanding provided that the present value of the amounts rescheduled is unchanged from what it would have been had relief been provided as assigned in each year of the four-year period. The United States will thus reschedule the following amounts due to the Agency for International Development in such amounts as follows:

US FY 1975	$38.5 million
FY 1976	$49.8 million
FY 1977	$53.1 million
FY 1978	$44.2 million
FY 1979	$17.1 million
Total	$202.7 million

The amount the United States will reschedule in FY 1979 is subject to revision -- as are the final amounts being rescheduled by the other creditor countries -- to ensure that the total amount of relief received by Pakistan is as agreed in the Memorandum of Understanding.

Directly related to the agreement with Pakistan, is an agreement by the Government of Bangladesh to assume liability for projects visibly located in its territory. In the case of the United States, Bangladesh will resume repayment obligations on $85.1 million in principal amount on visible United States project loans. The United States and other creditors have agreed that such loans assumed by Bangladesh will be rescheduled on terms equivalent to a minimum of 84 percent grant element.

We believe the agreements are in the interest of the United States since the creditor countries' objective of avoiding a default on any portion of the pre-war Pakistan debt has been accomplished. The United States share of debt relief for Pakistan is reasonable since we were the creditor on about two-thirds of the debt originally disputed by Pakistan.

I willbe happy to provide you with any additional information on this matter.

Sincerely yours,

Robert J. McCloskey
Assistant Secretary for
Congressional Relations

Enclosures:

1. Bilateral Agreements.
2. Multilateral Understanding.

DEPARTMENT OF STATE

Washington, D.C. 20520

March 22, 1976

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 Committee on Foreign Relations 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 agreements with Pakistan and Bangladesh. The agreement with Pakistan will reschedule approximately $203 million in debt service falling due over the five year FY1975-79 period. The United States will also reschedule $85 million in debt service obligations being assumed by Bangladesh. Bangladesh will also assume responsibility for servicing $2.6 million in Export-Import Bank loans which will not be rescheduled. The agreement implements an understanding reached with Pakistan by the World Bank, in its capacity as Chairman of the Pakistan Consortium, on June 28, 1974. Former Chairman Fulbright was informed of these debt rescheduling negotiations in letters dated August 14, 1974 and June 27, 1974.

As noted in our letters to Chairman Fulbright, United States negotiations with Pakistan and Bangladesh were in response to unique circumstances that arose as a result of the 1971 war and the independence of Bangladesh. After the war Pakistan insisted that debts resulting from programs of primary benefit to Bangladesh should be paid by Bangladesh. For its part, Bangladesh affirmed its intention to assume the international responsibilities incumbent upon a sovereign state,

Honorable John Sparkman, Chairman
Committee on Foreign Relations
United States Senate
Washington, D.C.

including a portion of the external debt of the formerly united Pakistan, but only within the context of an overall financial settlement.

The creditors of the Aid-to-Pakistan Consortium agreed to work towards developing a procedure to overcome the impasse with the aim of avoiding a default on any portion of the total debt. The creditors also sought to frame any agreement in the context of Pakistan's unique situation so as to avoid setting an undesirable precedent for other countries. In order to facilitate a final settlement which would achieve creditor objectives, the Aid-to-Pakistan Consortium agreed to short-term debt reschedulings in 1972 and 1973. United States implementation of the 1973 understanding, under which the United States agreed to reschedule approximately $23 million in debt falling due between July 1, 1973 and June 30, 1974, is also formalized in the current agreement.

In the June 28, 1974, Memorandum of Understanding the creditor countries agreed to provide debt relief to Pakistan in the amount of $650 million, to be provided over the four years beginning July 1, 1974. The creditors also agreed that the terms of relief would be at a grant element of no less than 62 percent. Pakistan has agreed to continue payments upon all debt due to creditors in the participating countries. The United States share of relief to be provided to Pakistan over the four years is about $196 million. The actual amount the United States has decided to reschedule during this period is $186 million. The United States will, however, provide compensating relief in a fifth year, an option permitted in the Memorandum of Understanding provided that the present value of the amounts rescheduled is unchanged from what it would have been had relief been provided as assigned in each year of the four-year period. The United States will thus reschedule the following amounts due to the Agency for International Development in such amounts as follows:

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FY 1977	$53.1 million
FY 1978	$44.2 million
FY 1979	$17.1 million
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Directly related to the agreement with Pakistan, is an agreement by the Government of Bangladesh to assume liability for projects visibly located in its territory. In the case of the United States, Bangladesh will resume repayment obligations on $85.1 million in principal amount on visible United States project loans. The United States and other creditors have agreed that such loans assumed by Bangladesh will be rescheduled on terms equivalent to a minimum of 84 percent grant element.

We believe the agreements are in the interest of the United States since the creditor countries' objective of avoiding a default on any portion of the pre-war Pakistan debt has been accomplished. The United States share of debt relief for Pakistan is reasonable since we were the creditor on about two-thirds of the debt originally disputed by Pakistan.

I will be happy to provide you with any additional information on this matter.

Sincerely,

Robert J. McCloskey
Assistant Secretary for
Congressional Relations

Enclosures:
1. Bilateral Agreements.
2. Multilateral Understanding.

AGREEMENT BETWEEN
THE UNITED STATES OF AMERICA AND
THE ISLAMIC REPUBLIC OF PAKISTAN
REGARDING CONSOLIDATION AND RESCHEDULING

The United States of America ("United States") and the Islamic Republic of Pakistan ("Pakistan") desiring to carry out the mutual intentions of the United States, Pakistan, and other creditor nations regarding debt division and debt relief set forth in the Memorandums of Understanding on Debt Relief for Pakistan, dated July 31, 1973, and June 28, 1974, and signed by the Government of Pakistan and by the International Bank for Reconstruction and Development as Chairman of the Aid-to-Pakistan Consortium hereby

ARTICLE I

PAST DUE DEBT

1. Debts due in Fiscal Year Ending June 30, 1973 (including arrearages). Pursuant to the September 20, 1972 Agreement between the United States and the President of Pakistan, certain loan payments of principal and interest owed to the United States and falling due between May 1, 1971, and June 30, 1973, were deferred and rescheduled. Such agreement is hereby ratified and confirmed, and Pakistan agrees to repay such deferred debt in accordance with such agreement, subject to the further amendment and rescheduling of certain of the underlying loans effected by Article II below.

2. Debts Due in Fiscal Year Ending June 30, 1974. Pursuant to the Memorandum of Understanding on Debt Relief for Pakistan, dated July 31, 1973, certain loan payments of principal and interest owed to the United States and falling due on specified dates between July 1, 1973, and June 30, 1974, were deferred. The sum of payments due and deferred, listed in Annex A, Part I, amounts to $23,201,621.25 ("1974 Consolidated Debt"). Pakistan agrees to pay the 1974 Consolidated Debt in accordance with the following terms, subject to the further amendment and rescheduling of certain of the underlying loans effected by Article II below.

A. Interest: Pakistan shall pay to the United States interest which shall accrue at the rate of 1.7% per annum on the outstanding balance of the 1974 Consolidated Debt and on any due and unpaid interest accruing thereon. Interest on such outstanding balance shall accrue from the last due date of those underlying loans and shall be computed on the basis of a 365-day year. Interest shall be paid semi-annually commencing on December 31, 1974.

B. __Principal:__ Pakistan shall repay to the United States the 1974 Consolidated Debt within four (4) years from July 1, 1974, including a one (1) year grace period. Principal payments shall be made in six (6) approximately equal semi-annual installments commencing December 31, 1975, with the final payment due June 30, 1978.

C. __Amortization Schedule:__ Attached hereto as Annex A are two (2) amortization schedules, Part II and Part III, the sum of which equals the total amount of the deferral and rescheduling mentioned in paragraph 2 immediately above. The amounts shown on Part II of Annex A represent the amounts eligible for further deferral and rescheduling by application of the principles agreed to in Article II below.

ARTICLE II

__CURRENT AND FUTURE DEBT__

1. __Debt Relief.__

A. Reference is made to the Memorandum of Understanding on Debt Relief for Pakistan dated June 28, 1974. In furtherance of the intentions set forth therein, the United States undertakes a qualified obligation (subject to subparagraph B below) to defer and reschedule debt service due to the United States on debts incurred by Pakistan prior to July 1, 1973, at such times and in such amounts as follows:

United States Fiscal Year	1975 -	$54,013,000
	1976 -	50,423,000
	1977 -	52,694,000
	1978 -	38,904,000

B. The obligation of the United States Government to so defer and reschedule, however, is expressly conditioned by the understanding that the United States shall only defer and reschedule payments on those categories of loans of the United States Agency for International Development which were originally disputed by Pakistan as a result of the events of 1971. A list of these loans together with the principal amounts ascribed thereto appears on Annex B attached hereto, and the loans are hereafter referred to as "Annex B Loans". The United States shall only defer and reschedule payments due under Annex B Loans for amounts not subsequently assumed by Bangladesh (including payments due on such Annex B Loans which have been rescheduled as set forth in Article I hereof). Until the United States shall have provided the total debt relief to Pakistan set forth in the Memorandum of Understanding of June 28, 1974, the United States shall annually defer and reschedule all of the payments due on each of the Annex B Loans with the exception of interest payments due as a result of paragraph 2 of this Article II. If, as it appears, the United States shall not have deferred and rescheduled by June 30, 1978, the stated dollar amounts indicated in subparagraph A above, the United States shall provide equivalent debt relief in the form of deferral and rescheduling of additional debt service due under Annex B Loans in fiscal year 1979. The amount of such additional debt relief to be given shall be determined by application of subparagraph C below.

C. The present value of the debt relief to be provided by the United States under this Agreement, when discounted at 10 percent pursuant to the Memorandum of Understanding of June 28, 1974, is $172,600,000 computed as follows:

United States Fiscal Year	Amount to be Rescheduled Per Subparagraph A		Discount Factor		Discounted Present Value of Amount to be Rescheduled
1975	$54,013,000	x	1.000	=	$54,013,000
1976	$50,423,000	x	.909	=	$45,834,000
1977	$52,695,000	x	.826	=	$43,526,000
1978	$38,904,000	x	.751	=	$29,217,000
					$172,600,000

As the principal amount available for rescheduling of Annex B Loans by the United States will not enable the United States to provide debt relief in the amounts assigned under subparagraph A above during each year, the United States shall provide equivalent relief through fiscal year 1979 in such amounts so that the present value of the actual amount deferred and rescheduled, when discounted at 10 percent (10%) to the year in which it should have been given, is unchanged. Thus, when after four years of deferral and rescheduling of the debt service on Annex B Loans, the discounted present value of the amounts actually deferred and rescheduled is less than $172,600,000, the United States in order to meet the difference will defer and reschedule debt service due on Annex B Loans in fiscal year 1979.

D. In order to provide debt relief equal to a discounted present value of $172,600,000, the United States will defer and reschedule payments on Annex B Loans in such amounts as follows:

United States Fiscal Year	Amount to be Rescheduled on Annex B Loans	Discount Factor	Discounted Present Value of Amount to be Rescheduled
1975	$38,463,586.71	x 1.000	= $38,463,586.71
1976	$49,830,988.82	x .909	= $45,296,368.84
1977	$53,144,972.58	x .826	= $43,897,747.35
1978	$44,250,372.62	x .751	= $33,232,029.84
1979	$17,145,340.05	x .683	= $11,710,267.26
			$172,600,000.00

E. The total amount the United States will defer and reschedule will be adjusted to reflect agreed changes which would insure that the amounts of relief received by Pakistan from participating creditor countries are in accordance with paragraph 3a of the June 28 Memorandum of Understanding on Debt Relief for Pakistan.

F. All adjustments in the amount the United States will defer and reschedule required to implement subparagraph E above will be effected in fiscal year 1979. The formula to determine the final amount of debt service that must be deferred and rescheduled in United States fiscal year 1979 is as follows: (X = amount to be deferred and rescheduled in fiscal year 1979; Y = the discounted present value of the debt relief to be provided by the United States under the June 28 Memorandum of Understanding; Z = $160,889,732.74, which is the discounted present value of the amounts the United States will defer and reschedule in the four year period fiscal 1975-78 as computed using the discount factors listed above.

2. Deferral and Rescheduling of Payments Due on Annex B Loans. When Annex B Loan payments become due on successive original amortization dates throughout the period for which debt relief is to be provided, the United States shall suspend the relevant billings and refinance each such payment obligation. The terms of such refinancing or rescheduling shall be as follows:

A. Annex B Loans Due for Repayment in Fiscal Year 1975-1979.

(i) Interest: Pakistan shall pay to the United States interest at a rate of 2.15% per annum on the outstanding balance of deferred and refinanced payments and on any due and unpaid interest thereon. Interest shall accrue from the date of each respective deferral and shall be computed on the basis of a 365-day year. Interest shall be due semi-annually, commencing on January 1, 1975.

(ii) Principal: Pakistan shall repay to the United States the aggregate amount of deferred and refinanced payments due in fiscal years 1975-79 ("1975-79 Principal") within thirty (30) years after July 1, 1974. Such 1975-79 Principal shall be paid in thirty-nine (39) equal semi-annual installments commencing July 1, 1985.

(iii) Adjustment of Terms: The rescheduling terms established above in subparagraphs (i) and (ii) constitute a grant element of 62.11 percent, and thus meet the 62 percent grant element provision of the June 28, 1974, Memorandum of Understanding. If it is necessary to adjust the amount the United States will defer and reschedule in fiscal year 1979 for reasons noted in paragraphs 1(E) and 1(F), both Pakistan and the United States shall have the right to obtain adjustments in the interest rate charged on the amounts rescheduled in fiscal year 1979. Such changes in interest reflect the fact that the Agreement intends to provide rescheduling terms no more or less favorable than the 62 percent target agreed in the June 28, 1974 Memorandum of Understanding.

B. Amortization Schedule. The United States will issue to Pakistan amortization schedules in accordance with the foregoing prior to the initial principal due date, i.e., prior to July 1, 1985.

C. Debt Division. It is the mutual understanding of the parties hereto that the Peoples' Republic of Bangladesh, by agreement with the United States (whenever signed), will assume responsibility to perform all payment obligations first becoming due on July 1, 1974, and thereafter, arising under certain loans relating to visible projects located in the area now constitutin Bangladesh. Such loans and the principal amounts ascribed there appear in Annex C attached hereto (the "Visible Project Loans"). As and to the extent that such repayment responsibility is assumed by Bangladesh, Pakistan shall be released and discharged from such responsibility.

ARTICLE III

GENERAL COVENANTS

1. Application and Place of Payments. All payments to b made pursuant to the terms hereof shall be applied first to the payment of the accrued interest and then to the repayment of principal due. Except as the United States may otherwise speci in writing, all such payments shall be made to the Controller, Agency for International Development, Washington, D.C., U.S.A.

and shall be deemed made when received by the Office of the Controller.

2. Full Force and Effect of Annex B Loans. To the extent not expressly amended by this Agreement or rendered inconsistent hereby, the terms and conditions of the loan agreements between the United States and Pakistan which are the subject of this Agreement shall remain in full force and effect.

3. Further Assurances. The United States and Pakistan shall, at the request of either party hereto, execute and deliver such instruments and otherwise take such steps as may be reasonably proper and within their competence to effectuate the foregoing.

4. Effective Date. The conditions precendent to the effectiveness of this Agreement are:

A. This Agreement will enter into force when the Government of the United States notifies the Government of the Islamic Republic of Pakistan in writing that domestic United States laws and regulations covering debt rescheduling concerning this Agreement have been complied with.

B. The receipt by the United States, in form and substance satisfactory to the United States, of an opinion of the Ministry of Law and Parliamentary Affairs (Law Division) Government of Pakistan to the effect that this Agreement has been duly authorized or ratified by and executed on behalf of Pakistan and that it constitutes a valid and legally binding obligation of Pakistan in accordance with all of its terms.

If, after sixty (60) days from the date hereof, or such later date as mutually agreed upon in writing, the above conditions precedent shall not have been fulfilled, this Agreemen shall be null and void. The United States shall notify Pakistan upon its determination that the conditions precedent have been fulfilled.

IN WITNESS WHEREOF, the undersigned, being duly authorized for this purpose, have signed this Agreement.

DONE in duplicate, at Washington on the fourth day of March, 1976.

FOR THE UNITED STATES OF AMERICA:	FOR THE ISLAMIC REPUBLIC OF PAKISTAN:

Agency for International Development
Pakistan - Amounts Rescheduled
Due from July 1, 1973 thru June 30, 1974
Annex B Loans

Loan Number	Rescheduled Amount
391-A-032A	$ 37,382.14
391-A-032R	753.26
391-H-039	3,519,587.77
391-H-039R	45,093.77
391-H-043	254,462.17
391-H-043R	1,498.04
391-H-045	1,114,465.82
391-H-045R	10,036.64
391-H-046	1,497,276.44
391-H-046R	13,564.55
391-H-052	4,055.33
391-H-052R	24.09
391-H-053	102,648.08
391-H-053R	677.37
391-H-054	13,379.38
391-H-054R	201.82
391-H-056	1,180,712.11
391-H-056R	7,810.94
391-H-057	17,558.86
391-H-057R	264.80
391-H-058	29,062.82
391-H-058R	172.56
391-H-059	101,404.81
391-H-059R	480.00
391-H-062	32,529.12
391-H-062R	490.68
391-H-066	2,709,958.56
391-H-066R	9,545.08
391-H-068	11,170.86
391-H-068R	168.52
391-H-071	32,405.12
391-H-071R	610.24
391-H-073	9,749.44
391-H-073R	147.08
391-H-080	745,380.69
391-H-080R	11,246.71
391-H-081	28,553.44
391-H-081R	401.97
391-H-081A	4,406.00
391-H-158R	45.07

Agency for International Development
Pakistan - Amounts Rescheduled
Due from July 1, 1973 thru June 30, 1974
Annex B Loans

Loan Number	Rescheduled Amount
391-H-082	$ 61,215.30
391-H-082R	913.89
391-H-084	74,181.79
391-H-084R	1,401.38
391-H-089	61,497.22
391-H-089R	927.56
391-H-091	17,097.74
391-H-091R	231.29
391-H-092	78,660.31
391-H-092R	1,454.30
391-H-094	17,449.52
391-H-094R	262.13
391-H-096	1,034,496.13
391-H-096R	15,610.51
391-H-115	491,780.39
391-H-115R	9,928.18
391-H-117	701,157.37
391-H-117R	17,705.21
391-H-121	700,385.57
391-H-121R	14,117.08
391-H-124	10,559.09
391-H-124R	222.78
391-H-127	237,762.99
391-H-127R	4,791.05
391-H-128	33,433.02
391-H-128R	844.23
391-H-131	2,277,375.45
391-H-131R	92,487.50
391-H-135	107,461.13
391-H-135R	4,352.96
391-H-136	18,886.88
391-H-136R	766.88
391-H-139	428.75
391-H-139R	17.41
391-H-140	1,339,472.72
391-H-140R	54,402.28
391-H-142	28,938.80
391-H-142R	1,123.03
391-H-143	2,738.37
391-H-143R	71.15

Agency for International Development
Pakistan - Amounts Rescheduled
Due from July 1, 1973 thru June 30, 1974
Annex B Loans

Loan Number	Rescheduled Amount
391-H-144	$ 400,825.46
391-H-144R	14,363.60
391-H-148	1,992,732.14
391-H-148R	66,776.44
391-H-154	278,450.40
	$ 21,819,213.89
Consolidated Debt Interest Due 6-30-74	97,112.61
	$ 21,916,326.50

Agency for International Development
Pakistan - Amounts Rescheduled
Due from July 1, 1973 thru June 30, 1974
Loans Not Listed in Annex B

Loan Number	Rescheduled Amount
391-H-055	$ 223,796.40
391-H-055R	1,061.03
391-H-060	4,331.60
391-H-060R	65.34
391-H-069	41,952.20
391-H-069R	632.82
391-H-070	104,481.46
391-H-070R	1,973.77
391-H-072	35,113.38
391-H-072R	529.67
391-H-078	19,851.74
391-H-078R	299.46
391-H-079	12,882.29
391-H-079R	243.36
391-H-083	120,537.02
391-H-083R	1,821.27
391-H-085	55,957.65
391-H-085R	847.81
391-H-086	32,900.68
391-H-086R	621.52
391-H-087	78,289.63
391-H-087R	1,134.82
391-H-088	44,540.59
391-H-088R	841.41
391-H-090	91,821.98
391-H-090R	1,739.72
391-H-102	70,221.73
391-H-102R	1,776.15
391-H-103	5,546.78
391-H-103R	111.77
391-H-104	26,439.25
391-H-104R	532.77
391-H-106	48,112.84
391-H-106R	969.50
391-H-107	59,466.58
391-H-107R	1,198.29
391-H-126	32,985.57
391-H-126R	621.95
391-H-129	151,323.98
391-H-129R	3,679.88
	$ 1,281,255.72
Consolidated Debt Interest Due 6-30-74	4,039.03
	$ 1,285,294.75

Annex A
Part II

Agency for International Development
Pakistan - Repayment Schedule
1974 Consolidated Debt
Annex B Loans - Interest Rate 1.7%

Date Due	Total Installment	Principal	Interest	Balance Outstanding
				$ 21,916,326.50
12-31-74	$ 186,288.78	$ -0-	$ 186,288.78	
				21,916,326.50
06-30-75	186,288.78	-0-	186,288.78	
				21,916,326.50
12-31-75	3,839,009.86	3,652,721.08	186,288.78	
				18,263,605.42
06-30-76	3,807,961.73	3,652,721.08	155,240.65	
				14,610,884.34
12-31-76	3,776,913.60	3,652,721.08	124,192.52	
				10,958,163.26
06-30-77	3,745,865.47	3,652,721.08	93,144.39	
				7,305,442.18
12-31-77	3,714,817.34	3,652,721.08	62,096.26	
				3,652,721.10
06-30-78	3,683,769.23	3,652,721.10	31,048.13	
				-0-
	$ 22,940,914.79	$ 21,916,326.50	$ 1,024,588.29	

Annex A
Part III

Agency for International Development
Pakistan - Repayment Schedule
1974 Consolidated Debt
Loans not Listed in Annex B - Interest Rate 1.7%

Date Due	Total Installment	Principal	Interest	Balance Outstanding
				$ 1,285,294.75
12-31-74	$ 10,925.01	$ -0-	$ 10,925.01	
				1,285,294.75
06-30-75	10,925.01	-0-	10,925.01	
				1,285,294.75
12-31-75	225,140.80	214,215.79	10,925.01	
				1,071,078.96
06-30-76	223,319.96	214,215.79	9,104.17	
				856,863.17
12-31-76	221,499.13	214,215.79	7,283.34	
				642,647.38
06-30-77	219,678.29	214,215.79	5,462.50	
				428,431.59
12-31-77	217,857.46	214,215.79	3,641.67	
				214,215.80
06-30-78	216,036.63	214,215.80	1,820.83	
				-0-
	$ 1,345,382.29	$ 1,285,294.75	$ 60,087.54	

Agency for International Development
Pakistan - "Annex B Loans"
Long-Term Debt Relief

Loan Number	Outstanding Balance 6-30-79 1/
391-A-032A	$ 3,565,892.82
391-A-032R	75,139.03
391-H-039	80,916,784.51
391-H-039R	6,001,250.98
391-H-043R	199,364.98
391-H-045	20,498,248.93
391-H-045R	1,343,725.78
391-H-046	38,283,813.91
391-H-046R	1,805,215.36
391-H-052	166,845.64
391-H-052R	3,204.44
391-H-053	1,094,568.77
391-H-053R	90,146.78
391-H-054	1,121,473.55
391-H-054R	26,859.20
391-H-056	27,939,811.11
391-H-056R	1,039,508.68
391-H-057R	35,241.20
391-H-058	276,498.37
391-H-058R	22,964.75
391-H-059R	63,879.37
391-H-062R	65,302.62
391-H-066	65,038,237.37
391-H-066R	1,270,296.35
391-H-068R	22,425.67
391-H-071	1,312,030.91
391-H-071R	81,212.96
391-H-073R	19,572.52
391-H-080	99,195,807.61
391-H-080R	1,496,755.67
391-H-081R	53,495.60
391-H-158R	4,496.98
391-H-082R	121,624.48
391-H-084	3,881,819.38
391-H-084R	186,500.95
391-H-089R	123,456.53
391-H-091R	30,781.18
391-H-092R	193,543.24
391-H-094R	34,884.56
391-H-096	137,672,197.52
391-H-096R	2,077,506.22
391-H-115	49,055,400.03
391-H-115R	990,342.90

Agency for International Development
Pakistan - "Annex B Loans"
Long-Term Debt Relief

Loan Number	Outstanding Balance 6-30-74 1/
391-H-117	$ 69,940,884.07
391-H-117R	1,766,105.67
391-H-121	69,865,525.18
391-H-121R	1,408,187.41
391-H-124R	22,221.99
391-H-127	23,717,006.73
391-H-127R	477,910.80
391-H-128	768,024.75
391-H-128R	84,212.07
391-H-131	113,285,476.21
391-H-131R	4,601,367.80
391-H-135	2,037,611.66
391-H-135R	216,565.06
391-H-136R	38,152.86
391-H-139R	866.13
391-H-140	66,640,434.19
391-H-140R	2,706,580.79
391-H-142	747,765.06 2/
391-H-142R	55,872.11
391-H-143R	3,539.91
391-H-144	19,941,564.60
391-H-144R	714,607.10
391-H-148	98,570,115.54
391-H-148R	3,322,210.90
391-H-152	50,449,950.56 2/
391-H-153	20,508,428.88 2/
391-H-154	19,409,185.31 2/
1974 Consolidated Debt	21,916,326.50

1/ These amounts represent that portion of the June 30, 1974 outstanding balance for each of the underlying loans which are to be rescheduled in accordance with Article II of this agreement.

2/ Loans which are not fully disbursed as of June 30, 1974. Subsequent disbursements under these four (4) loans will be rescheduled in accordance with Article II of this Agreement.

ANNEX C
Part I

Agency for International Development
Pakistan
Visible Project Loans
Debts to be Assumed by Bangladesh

Loan Number	Name of Project	Amount
391-H-043	E.P. Power Distribution	$ 6,021,828.57
391-H-057	Chalna Anchorage	2,336,799.25
391-H-059	Coastal Embankment	4,171,834.10
391-H-062	General Consultants	4,327,096.48
391-H-068	Public Health Engineering	1,486,661.69
391-H-073	Mechanical Equipment Org.	1,397,493.37
391-H-081	Karnaphuli Third Unit	3,900,000.00
391-H-081A	Karnaphuli Third Unit	1,049,560.41
391-H-082	Siddhirgenj Thermal Plant	8,166,474.05
391-H-089	Pakistan Eastern Railway I	8,184,283.71
391-H-091	E.P. Transmission Lines	2,278,231.34
391-H-092	Dacca-Aricha Road	10,468,414.63
391-H-094	Chittagang Port	2,413,778.15
391-H-124	E.P. Water and Power Development	1,054,079.38
391-H-136	E.P. Public Health Engineering	939,646.44
391-H-139	E.P. Seed Potato Multiplication and Storage	26,728.08
391-H-143	E.P. Ground Water Survey	136,237.07
391-H-032	Picic-Third Loan	163,000.00
391-H-048	Railways-Fourth	7,998,000.00
391-H-053	Malaria Eradication	1,334,631.00
391-H-054	Airport & Airways Equipment	659,105.85
391-H-058	Feasibility Sectoral Studies	919,219.00
391-H-071	Telecommunication Facilities	3,276,733.77
391-H-084	Malaria Eradication-Second	5,990,576.00
391-H-128	Malaria Eradication-Third	2,566,940.49
391-H-135	Malaria Eradication-Fourth	3,308,713.00
391-H-142 2/	Consulting Services	721,170.78
		$85,101,236.36 1/

1/ Includes Contractor claims approved by GOP prior to July 1, 1974 but not yet disbursed.

2/ This loan is not fully disbursed. Future disbursements will be the liability of the GOP.

ANNEX C
PART II

EXPORT-IMPORT BANK OF THE UNITED STATES

VISIBLE PROJECT LOANS
DEBTS TO BE ASSUMED BY BANGLADESH

Exim Credit No.	Name of Project	Amount 1/
2627	IDBP - Relending Credit	5,173.00
2359/1984C	IDBP - Relending Credit	292,245.45
2792	PICIC - Relending Credit	323,118.10
1984B	Dacca - Intercontinental Hotel	1,952,718.65
		$2,573,255.20

1/ These amounts represent the outstanding balances on these credits as of June 30, 1974 attributable to Bangladesh.

AGREEMENT BETWEEN
THE UNITED STATES OF AMERICA
AND THE PEOPLE'S REPUBLIC OF BANGLADESH

The United States of America ("United States") and the People's Republic of Bangladesh ("Bangladesh");

Having participated in a series of negotiations between Bangladesh and the creditor nations including the United States with respect to pre-1971 foreign debts, wherein the Government of Bangladesh has agreed to assume the performance of certain repayment obligations with respect to certain projects visibly located in the territories now comprised in Bangladesh; and

As a consequence of such acceptance of obligations with respect to visible project loans, the United States, among other things, has agreed to provide certain debt relief to Bangladesh and cooperate with the creditor nations on matters concerning the general economic situation in Bangladesh;

The parties hereto have therefore agreed as follows:

ARTICLE I

Visible Project Loans

1. Definition. "Visible Project Loans" as such term is used herein refers exclusively to those loans (and amounts ascribed thereto due and payable on and after July 1, 1974) listed on Annexes A and B attached hereto which are deemed to relate to visible projects now located in the area comprising Bangladesh.

2. Assumption of Visible Project Loans. Bangladesh hereby assumes the performance of all payment obligations pertaining to the Visible Project Loans and, except as such loans are amended hereby, agrees to perform such payment obligations all with full force and effect as if Bangladesh had originally contracted for the Visible Project Loans as the "borrower" named therein.

3. Further Assurances. The parties hereto shall at the request of either party execute and deliver such instruments and otherwise take such steps as may be reasonable and proper to effectuate the foregoing assumption of responsibility by Bangladesh.

ARTICLE II

Payments and Terms

1. Consolidation and Amendment. The total principal amount due on the Visible Project Loans appearing in Annex A is $85,101,236.36 (the "Consolidated Principal").

(a) Interest: Bangladesh shall pay to the United States interest which shall accrue at the rate of 1.6 percent per annum on outstanding balance of the Consolidated Principal and on any due and unpaid interest. Interest shall accrue from the last payment due date in United States fiscal year 1974 on each of the underlying loans and shall be computed on the basis of a 365-day year. Interest shall be due semi-annually commencing July 1, 1974. Payments of interest due in accordance with this Agreement, beginning July 1, 1974 through January 1, 1989 inclusive, shall be capitalized and added to the Consolidated Principal on the dates such interest would otherwise be payable.

(b) Payment: Bangladesh shall pay to the United States the Consolidated Principal within forty (40) years from July 1, 1974, including a fifteen (15) year grace period. Payments shall be made in fifty-one (51) approximately equal semi-annual installments of principal and interest. The first installment of principal shall be due July 1, 1989. Attached hereto as Annex C is an amortization schedule calculated in accordance with the terms of this Agreement.

2. Application, Currency and Place of Payment. All payments of interest and principal made pursuant to the terms of Article II hereunder shall be made in United States dollars and shall be applied first to the payment of interest due and then to the payment of principal. Except as the United States may otherwise specify in writing, all such payments shall be made to the Controller, Agency for International Development, Washington, District of Columbia, United States of America and shall be deemed made when received by the Office of the Controller.

3. Prepayment. Upon payment of all interest then due, Bangladesh may prepay, without penalty, all or any part of the installments of Consolidated Principal in the inverse order of their maturity.

4. Renegotiation. Bangladesh agrees to negotiate with the United States, at such time or times as the United States may request, an acceleration of the payment of the Consolidated Principal in the event that there is significant improvement in the internal and external economic and financial position and prospects of Bangladesh.

ARTICLE III

Special Covenants

1. Information and Reports. Bangladesh shall furnish to the United States such information and reports relating to the Visible Project Loans as the United States may reasonably request. The authorized representatives of the United States shall have the right at all reasonable times to inspect the visible projects, the utilization of all goods and services financed under the Visible Project Loans and the books, records, and other documents in the possession of Bangladesh relating to the visible projects.

2. Events of Default; Acceleration. If Bangladesh shall have failed to pay when due any interest or installment of principal required under this Agreement or required under any other loan agreement or guaranty agreement between the United States and Bangladesh, Bangladesh shall be deemed to be in default under this Agreement. Unless the event of default is cured within ninety (90) days after the United States gives notice to Bangladesh of such default, the United States may, at its option, declare the entire amount of the unpaid principal and interest to be due and payable immediately.

ARTICLE IV

Miscellaneous

1. Communication. Any notice, request, document, or other communication given, made or sent by the United States or Bangladesh pursuant to this Agreement shall be in writing and shall be deemed to have been duly given, made or sent to the party to which it is addressed when it shall be delivered to such party by hand or by mail, telegram, or radiogram at the following addresses:

To the United States: the United States Ambassador to Bangladesh

To Bangladesh: Secretary, Planning Commission, Ministry of Planning, Government of Bangladesh

2. Representatives. For all purposes relative to this Agreement, the United States will be represented by the individual holding or acting in the office of Ambassador to Bangladesh and Bangladesh will be represented by the individual holding or acting in the office of Secretary, Planning Commission, Ministry of Planning. Such individuals shall have the authority to designate additional representatives by written notice.

3. Promissory Notes. At such time or times as the United States may request, Bangladesh shall issue promissory notes or such other evidence of indebtedness with respect to this Agreement and the Visible Project Loans, in such form, containing such terms and supported by such legal opinions as the United States may reasonably request.

4. Termination on Full Payment. Upon payment in full of the outstanding principal on the visible project loans and of any accrued and unpaid interest thereon, this Agreement and all obligations of Bangladesh under the Visible Project Loans shall terminate.

5. Effective Date. The conditions precedent to the entry into force of this Agreement are:

(a) Notification of the Government of the People's Republic of Bangladesh in writing by the Government of the United States that domestic United States laws and regulations covering debt rescheduling have been complied with; and

(b) The receipt by the United States, in form and substance satisfactory to the United States, of an opinion of the Ministry of Justice of Bangladesh to the effect that this Agreement has been duly authorized or ratified by, and executed on behalf of Bangladesh and that it constitutes a valid and legally binding obligation of Bangladesh in accordance with all of its terms.

If, after sixty days (60) from the date hereof, or such later date as the parties mutually agree in writing, the above conditions precedent shall not have been fulfilled, this Agreement shall be null and void. The United States shall notify Bangladesh upon its determination that the conditions precedent have been fulfilled.

DONE in duplicate at Washington this 3rd day of March 1976.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

Paul H. Boeker

FOR THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF BANGLADESH:

R. R. Siddiqi

ANNEX A

Agency for International Development

Visible Project Loans
Debts to be Assumed by Bangladesh

Loan Number	Name of Project	Amount
391-H-043	E.P. Power Distribution	$ 6,021,920.57
391-H-057	Chalna Anchorage	2,336,799.25
391-H-059	Coastal Embankment	4,171,834.20
391-H-062	General Consultants	4,329,096.18
391-H-068	Public Health Engineering	1,486,661.69
391-H-073	Mechanical Equipment Org.	1,297,493.37
391-H-081	Karnaphuli Third Unit	3,800,000.00
391-H-081A	Karnaphuli Third Unit	1,049,560.41
391-H-082	Siddhirgenj Thermal Plant	8,166,474.05
391-H-089	Pakistan Eastern Railway I	8,184,283.71
391-H-091	E.P. Transmission Lines	2,278,131.34
391-H-092	Dacca-Aricha Road	10,468,414.68
391-H-094	Chittagang Port	2,413,778.15
391-H-124	E.P. Water and Power Development	1,054,079.28
391-H-136	E.P. Public Health Engineering	939,646.44
391-H-139	E.P. Seed Potato Multiplication and Storage	26,728.08
391-H-143	E.P. Ground Water Survey	136,237.07
391-H-032	Picic-Third Loan	163,000.00
391-H-045	Railways-Fourth	7,998,000.00
391-H-053	Malaria Eradication	1,334,631.00
391-H-054	Airport & Airways Equipment	659,105.85
391-H-058	Feasibility Sectoral Studies	919,219.00
391-H-071	Telecommunication Facilities	3,278,733.77
391-H-084	Malaria Eradication-Second	5,990,576.00
391-H-128	Malaria Eradication-Third	2,566,940.49
391-H-135	Malaria Eradication-Fourth	3,308,713.00
391-H-142	Consulting Services	721,170.78
		$85,101,236.36 a

a/ Includes contractor claims approved by GOP prior to July 1, 1974 but not yet disbursed.

ANNEX B

EXPORT-IMPORT BANK OF THE UNITED STATES

VISIBLE PROJECT LOANS

DEBTS TO BE ASSUMED BY BANGLADESH

Exim Credit No.	Name of Project	Amount [1]
2627	IDBP - Relending Credit	5,173.00
2359/1984G	IDBP - Relending Credit	292,245.45
2792	PICIC - Relending Credit	323,118.10
1984B	Dacca - Intercontinental Hotel	1,952,718.65
		$2,573,255.20

[1] These amounts represent the outstanding balances on these credits as of June 30, 1974 attributable to Bangladesh.

ANNEX C

AGENCY FOR INTERNATIONAL DEVELOPMENT
BANGLADESH
SCHEDULE OF PAYMENTS

Rate 1.6%

Due Date	Installment Total	Interest	Principal	Interest Capitalized	Remaining Balance
					85,101,236.36
7/01/74	-0-	-0-	-0-	267,416.26	85,368,652.62
1/01/75	-0-	-0-	-0-	682,949.22	86,051,601.84
7/01/75	-0-	-0-	-0-	688,412.81	86,740,014.65
1/01/76	-0-	-0-	-0-	693,920.12	87,433,934.77
7/01/76	-0-	-0-	-0-	699,471.48	88,133,406.25
1/01/77	-0-	-0-	-0-	705,067.25	88,838,473.50
7/01/77	-0-	-0-	-0-	710,707.79	89,549,181.29
1/01/78	-0-	-0-	-0-	716,393.45	90,265,574.74
7/01/78	-0-	-0-	-0-	722,124.60	90,987,699.34
1/01/79	-0-	-0-	-0-	727,901.59	91,715,600.93
7/01/79	-0-	-0-	-0-	733,724.81	92,449,325.74
1/01/80	-0-	-0-	-0-	739,594.61	93,188,920.35
7/01/80	-0-	-0-	-0-	745,511.36	93,934,431.74
0/01/81	-0-	-0-	-0-	751,475.45	94,685,907.16
7/01/81	-0-	-0-	-0-	757,487.26	95,443,394.42
1/01/82	-0-	-0-	-0-	763,547.16	96,206,941.58
7/01/82	-0-	-0-	-0-	769,655.53	96,976,597.11
1/01/83	-0-	-0-	-0-	775,812.78	97,752,409.89
7/01/83	-0-	-0-	-0-	782,019.28	98,534,429.17
1/01/84	-0-	-0-	-0-	788,275.43	99,322,704.60
7/01/84	-0-	-0-	-0-	794,581.64	100,117,286.24
1/01/85	-0-	-0-	-0-	800,938.29	100,918,224.53
7/01/85	-0-	-0-	-0-	807,345.80	101,725,570.33
1/01/86	-0-	-0-	-0-	813,804.56	102,539,374.89
7/01/86	-0-	-0-	-0-	820,315.00	103,359,689.89
1/01/87	-0-	-0-	-0-	826,877.52	104,186,567.41
7/01/87	-0-	-0-	-0-	833,492.54	105,020,059.95
1/01/88	-0-	-0-	-0-	840,160.48	105,860,220.43
7/01/88	-0-	-0-	-0-	846,881.76	106,707,102.19
1/01/89	-0-	-0-	-0-	853,656.82	107,560,759.01
7/01/89	2,576,762.69	860,486.07	1,716,276.62	-0-	105,844,482.39
1/01/90	2,576,762.69	846,755.86	1,730,006.83	-0-	104,114,475.56
7/01/90	2,576,762.69	832,915.80	1,743,846.89	-0-	102,370,628.67
1/01/91	2,576,762.69	818,965.03	1,757,797.66	-0-	100,612,831.01
7/01/91	2,576,762.69	804,902.65	1,771,860.04	-0-	98,840,970.97
1/01/92	2,576,762.69	790,727.77	1,786,034.92	-0-	97,054,936.05
7/01/92	2,576,762.69	776,439.49	1,800,323.20	-0-	95,254,612.85
1/01/93	2,576,762.69	762,036.90	1,814,725.79	-0-	93,439,887.06
7/01/93	2,576,762.69	747,519.10	1,829,243.59	-0-	91,610,643.47
1/01/94	2,576,762.69	732,885.15	1,843,877.54	-0-	89,766,765.93
7/01/94	2,576,762.69	718,134.13	1,858,628.56	-0-	87,908,137.37
1/01/95	2,576,762.69	703,265.10	1,873,497.59	-0-	86,034,639.78
7/01/95	2,576,762.69	688,277.12	1,888,485.57	-0-	84,146,154.21
1/01/96	2,576,762.69	673,169.23	1,903,593.46	-0-	82,242,560.75

ANNEX C

AGENCY FOR INTERNATIONAL DEVELOPMENT
BANGLADESH
SCHEDULE OF PAYMENTS

Rate 1.6%

Due Date	Installment Total	Interest	Principal	Interest Capitalized	Remaining Balance
7/01/96	2,576,762.69	657,940.49	1,918,822.20	-0-	80,323,738.55
1/01/97	2,576,762.69	642,589.91	1,934,172.78	-0-	78,389,565.77
7/01/97	2,576,762.69	627,116.53	1,949,646.16	-0-	76,439,919.61
1/01/98	2,576,762.69	611,519.36	1,965,243.33	-0-	74,474,676.28
7/01/98	2,576,762.69	595,797.41	1,980,965.28	-0-	72,493,711.00
1/01/99	2,576,762.69	579,949.69	1,996,813.00	-0-	70,496,898.00
7/01/99	2,576,762.69	563,975.18	2,012,787.51	-0-	68,484,110.49
1/01/00	2,576,762.69	547,872.88	2,028,889.81	-0-	66,455,220.68
7/01/00	2,576,762.69	531,641.77	2,045,120.92	-0-	64,410,099.76
1/01/01	2,576,762.69	515,280.80	2,061,481.89	-0-	62,348,617.87
7/01/01	2,576,762.69	498,788.94	2,077,973.75	-0-	60,270,644.12
1/01/02	2,576,762.69	482,165.15	2,094,597.54	-0-	58,176,046.58
7/01/02	2,576,762.69	465,408.37	2,111,354.32	-0-	56,064,692.26
1/01/03	2,576,762.69	448,517.54	2,128,245.15	-0-	53,936,447.11
7/01/03	2,576,762.69	431,491.58	2,145,271.11	-0-	51,791,176.00
1/01/04	2,576,762.69	414,329.41	2,162,433.28	-0-	49,628,742.72
7/01/04	2,576,762.69	397,029.94	2,179,732.75	-0-	47,449,009.97
1/01/05	2,576,762.69	379,592.08	2,197,170.61	-0-	45,251,839.36
7/01/05	2,576,762.69	362,014.71	2,214,747.98	-0-	43,037,091.38
1/01/06	2,576,762.69	344,296.73	2,232,465.96	-0-	40,804,625.42
7/01/06	2,576,762.69	326,437.00	2,250,325.69	-0-	38,554,299.73
1/01/07	2,576,762.69	308,434.40	2,268,328.29	-0-	36,285,971.44
7/01/07	2,576,762.69	290,287.77	2,286,474.92	-0-	33,999,496.52
1/01/08	2,576,762.69	271,995.97	2,304,766.72	-0-	31,694,729.80
7/01/08	2,576,762.69	253,557.84	2,323,204.85	-0-	29,371,524.95
1/01/09	2,576,762.69	234,972.20	2,341,790.49	-0-	27,029,734.46
7/01/09	2,576,762.69	216,237.88	2,360,524.81	-0-	24,669,209.65
1/01/10	2,576,762.69	197,353.68	2,379,409.01	-0-	22,289,800.64
7/01/10	2,576,762.69	178,318.41	2,398,444.28	-0-	19,891,356.36
1/01/11	2,576,762.69	159,130.85	2,417,631.84	-0-	17,473,724.52
7/01/11	2,576,762.69	139,789.80	2,436,972.89	-0-	15,036,751.63
1/01/12	2,576,762.69	120,294.01	2,456,468.68	-0-	12,580,282.95
7/01/12	2,576,762.69	100,642.26	2,476,120.43	-0-	10,104,162.52
1/01/13	2,576,762.69	80,833.30	2,495,929.39	-0-	7,608,233.13
7/01/13	2,576,762.69	60,865.87	2,515,896.82	-0-	5,092,336.31
1/01/14	2,576,762.69	40,738.69	2,536,024.00	-0-	2,556,312.31
7/01/14	2,576,762.69	20,450.50	2,556,312.31	-0-	-0-
TOTAL		23,854,138.30	107,560,759.01		

DEPARTMENT OF STATE

Washington, D.C. 20520

April 26, 1976

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 is participating in preliminary discussions with a group of creditor countries (the "Paris Club") to consider rescheduling certain amounts of Zaire's public external debt due in 1976. Thus some of the debts covered by the "Act" may eventually be subject to negotiation.

The creditor club forum is the traditional multilateral mechanism for debt rescheduling. Its function is to examine a nation's ability to meet its debt service obligations and, if it determines that a debtor is temporarily unable to meet these 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 -- particularly the desire of the creditors to maximize repayment -- and debt rescheduling is not used by creditor governments to provide development assistance. Use of the multilateral framework ensures the principle of non-discrimination and equality among all bilateral creditors.

Zaire confronts a serious debt servicing problem and has already accumulated considerable debt arrearages. The Government of Zaire's stabilization program, developed in connection with the recently concluded

The Honorable
Thomas E. Morgan,
Chairman,
Committee on Foreign Affairs,
House of Representatives.

IMF Stand-by Arrangement, includes a Zairian commitment to reschedule debt. Zaire has officially requested the creditors to participate in debt rescheduling, and the "Paris Club" is meeting to discuss this request. Given the current lack of comprehensive data on Zaire's total accumulation of debt, an exchange of data collected by individual creditors will be an important element in preliminary creditor discussions.

The Export-Import Bank is the largest United States Government creditor agency in Zaire, with approximately $48 million (including Financial Guarantees, FCIA Insurance and Commercial Bank Guarantees) in debt service falling due in 1976. Zaire's arrearages on Export-Import Bank exposure totaled $9.6 million at year-end 1975. Other agencies scheduled to receive much smaller amounts of debt service from Zaire in 1976 are the Agency for International Development, the Department of Agriculture (for both PL-480 and CCC) and the Department of Defense. Zaire is also in arrears on 1975 payments to the Agency for International Development and the Department of Defense.

I will be happy to provide any additional information on this matter, and will continue to keep you advised of future developments as they evolve.

Sincerely yours,

Robert J. McCloskey
Assistant Secretary for
Congressional Relations

April 26, 1976

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John J. Sparkman,
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Committee on Foreign Relations,
United States Senate.

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Sincerely yours,

Robert J. McCloskey
Assistant Secretary for
Congressional Relations

EB:A.Watson

NOMINATION OF W. MICHAEL BLUMENTHAL

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-FIFTH CONGRESS

FIRST SESSION

ON

THE NOMINATION OF

W. MICHAEL BLUMENTHAL, SECRETARY-DESIGNATE OF THE TREASURY

JANUARY 12, 1977

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

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NOMINATION OF W. MICHAEL BLUMENTHAL FOR SECRETARY OF THE TREASURY

WEDNESDAY, JANUARY 12, 1977

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m. in room 2221, the Dirksen Senate Office Building, Hon. Russell B. Long (chairman of the committee) presiding.

Present: Senators Long, Talmadge, Ribicoff, Harry F. Byrd, Jr., Nelson, Gravel, Bentsen, Hathaway, Haskell, Hansen, Packwood, and Schmitt.

The CHAIRMAN. The committee will come to order.

We are holding a hearing today on the qualifications of Mr. Michael Blumenthal, whom President-elect Carter has announced he has intended to nominate for Secretary of the Treasury.

Mr. Blumenthal comes to us with impressive credentials. First, I will ask Mr. Blumenthal to make his opening statement, after which I will call on Senators in the order that they arrived.

STATEMENT OF W. MICHAEL BLUMENTHAL, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, THE BENDIX CORP., SOUTHFIELD, MICH.

Mr. BLUMENTHAL. Thank you very much, Mr. Chairman and members of the committee.

I was honored when Governor Carter designated me to become his Secretary of the Treasury and it is an equally great privilege to appear here today before this committee in respect to my confirmation to that high office. I want to assure you, Mr. Chairman, and all members of the committee, that I will do my very best, if confirmed in this position, to work closely with you on many matters of importance relating to my responsibilities which will come before us.

In preparation for my appearance here today, I have consulted with the staff of this committee concerning the resolution of my potential conflicts of interest, and with my legal counsel who have advised me that, in light of the arrangements which I have made, my assumption to the Office of the Secretary of the Treasury will not result in any violation of the conflicts of interest law.

As I have informed the committee staff and the President-elect's transition staff, I will before my swearing in as Secretary of the Treasury sever all relationships with the Bendix Corp. except for my rights to pension benefits and entitlements under my 1973 agreement with Bendix—that is, the agreement which provides for payments following the termination of my employment with Bendix. With respect to this 1973 agreement, I will receive no payments whatsoever pursuant to the agreement while I am in office. My rights for the next 4 years will be satisfied by a payment prior to January 20, 1977, and, if I were to continue in a Government position for more than 4 years, future payments would be deferred until I leave public office.

The agreement specifically provides that I will not be required to consult at any time while I am in office nor will I be required to consult at any time after leaving office where consultation would involve a violation of the conflict of interest law.

With specific reference to my stock holdings, I propose to exercise additional options for Bendix shares which were granted to me in 1971 and 1973—and, because of Federal securities law considerations, will postpone that exercise until during the 5 business days after swearing in.

In addition, I have created a blind trust with Morgan Guaranty Trust Co. of New York as trustee, and I will transfer no later than October 31, 1977 any stockholdings, including all shares of Bendix not personally sold by me, to the blind trust with instructions that the trustee have full investment discretion and not disclose to me the identity of the trust investments. Moreover, the trust agreement expressly requires that the trustee diversify the portfolio on or before October 31, 1977 by reducing the holdings in any particular company to not more than 25 percent of the trust assets.

Finally, I will disqualify myself from participating in any way in any ruling, determination, proceeding or other particular matter in which Bendix, or certain other organizations with which I have a relationship, has a financial interest.

Mr. Chairman, I would be happy to answer any questions that you or any other member of the committee has for me.

The CHAIRMAN. Senator Riegle would like to be recognized, I believe.

STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator RIEGLE. Mr. Chairman, I appreciate the opportunity to appear with Mr. Blumenthal. I do so, not only for purposes of putting on the record an introduction that I think is appropriate to his background but also because we, from the State of Michigan, feel especially honored and privileged that he has been selected for this post.

Speaking for myself, as I look at the composition of the President-elect's Cabinet, I feel the best feelings about this particular Cabinet-designee. His record of service in the public arena, his record of service in the private arena, I think is one of the finest in the country and I think that his potential for exceptional service as Secretary of the Treasury is as high as it possibly could be.

If I may, rather than postpone your opportunity to question him, what I would like to do is insert into the record a detailed biographical sketch of Mr. Blumenthal that spells out his record of accomplishment at the Bendix Corp., his previous service, government service, and public service, both at the national level and at the State level and also I want to stress what I think is a unique aspect of this particular individual, and that is an element of exceptional business statesmanship, too seldom seen in the private sector. His leadership in terms of public issues and the forward movement of people from all backgrounds within his company, I think stands out perhaps above any other example in the United States.

Not only has there been exhibited that kind of human consciousness and social consciousness within that corporate setting, but it has not been at the expense of the financial success, the profit success of that corporation. The Bendix Co., I think is recognized as one of the best managed companies in the country, but it has been done in a manner that allows the people in that organization to grow at their maximum capacity.

I think this particular aspect of leadership that he has given the private sector is something that we can well use in the public sector.

I am delighted to welcome him today back to Washington and say that it is my prediction when the record of this administration is totaled up some years down the road that his accomplishment and record as Secretary of the Treasury, I think, will stand right at the top of the list.

I appreciate the courtesy of the committee and the chairman for allowing me to make these remarks.

[The biographical data of Mr. Blumenthal follows:]

W. Michael Blumenthal

Biographical Sketch

Werner Michael Blumenthal: Chairman of the Board and Chief Executive Officer of The Bendix Corporation, Southfield, Michigan; residence, Ann Arbor, Michigan; born, Oranienburg, Germany, January 3, 1926; graduated from University of California, Berkeley, California, 1951: Princeton University, Princeton, New Jersey, 1956; holds B.S., M.P.A. in Public Affairs, M.A. in Economics, Ph.D. in Economics; married Eileen Polley; children, Ann Margaret, born March 31, 1953; Gillian, born, October 28, 1955; Jane Eileen, born November 21, 1957.

1976-present, Chairman and Chief Executive Officer, The Bendix Corporation, Southfield, Michigan.

1972–1976, Chairman, President and Chief Executive Officer, The Bendix Corporation, Southfield, Michigan.

1971–1972, President and Chief Operating Officer, The Bendix Corporation, Southfield, Michigan.

1970–1971, Vice Chairman, The Bendix Corporation, Southfield, Michigan.

1967–1970, President, Bendix International, New York, New York.

1963–1967, U.S. Ambassador, President's Deputy Special Representative for Trade Negotiations, and Chairman, U.S. Delegation to Kennedy Round Trade Negotiations—Geneva, Switzerland.

1961–1963, Deputy Assistant Secretary of State for Economic Affairs, Department of State, Washington, D.C.

1957–1961, Vice President and Director, Crown Cork International Corporation, Jersey City, New Jersey.

1954–1957, Research Associate, Industrial Relations Section, Economics Department, Princeton University.

1953–1954, Fellow, Social Science Research Council.

Elected to Phi Beta Kappa, 1951; recipient of Management Man of the Year Award—1974; United Negro College Fund, Annual Medallion Founders Award.

Published writings: Co-Determination in the German Steel Industry; Disability Retirement in Industrial Pension Plans; A World of Preferences.

Officer, director or trustee of numerous business and non-profit organizations and educational institutions, including The Equitable Life Assurance Society of the United States, Princeton University, the Council on Foreign Relations, and The National Committee on U.S.-China Relations, Inc.

The CHAIRMAN. Thank you very much.

I am going to suggest to all members of the committee that we limit ourselves to 5 minutes for the first round of questions and thereafter I would suggest that we limit ourselves to 10 minutes. If anybody wants to pass, he can have 15 minutes on the second round, if he wants to take that much time. Those who want to ask only one or two questions can be accommodated the first time we go around.

Going in order that the Senators arrived, I call on Senator Packwood first.

Senator PACKWOOD. Mr. Blumenthal, I would say that you started with a good step with this committee as choosing Mr. Woodworth who has done much in the past in the interrelationship of the executive branch and this committee. I do apologize. I am going to leave as soon as I finish my questions. I am going to the Rules Committee, where we are trying to work out a method so we will not have these conflicts.

You were president of Bendix International I understood from 1967 to 1971. Is that the international sales arm of Bendix?

Mr. BLUMENTHAL. Right.

Senator PACKWOOD. You are very experienced in multinational corporation's investments overseas.

In your experience, in most multinational corporations, is the principal reason that they invest overseas to get inside a market, or to be close to a market overseas?

Mr. BLUMENTHAL. I would certainly say that market considerations in all business matters are by far the single most important motivating factor.

Senator PACKWOOD. Of course, you are familiar with the argument that comes up annually about foreign tax credits and deferral tax income to the United States?

Mr. BLUMENTHAL. I am.

Senator PACKWOOD. Do you recall either of those taxing devices as an inducement, an unjustifiable incentive that causes corporations to go overseas?

Mr. BLUMENTHAL. I do not believe, Senator, that these two matters, in and of themselves, would cause a corporation to do one thing or another. I think that they must be seen as a part of the totality of considerations, including, most importantly, and primarily, market considerations. Certainly it is very difficult to generalize.

In particular industries, particular countries, situations may differ.

I would say in overall terms, tax considerations are really only one aspect of the totality and not the most important aspect in determining where a company invests its resources.

Senator PACKWOOD. Based on your experience and knowledge, do you see any need to make any change in either the present foreign tax credit law or the deferral of taxation of foreign source income law.

Mr. BLUMENTHAL. I have for some time taken the position that I would be happiest if the tax laws work in such a way that there is really true neutrality between investments in this country and investments abroad. I would hope in a review of our entire tax code that we could test to see whether or not these particular provisions to which you refer and others that would have an influence do, in fact, provide such neutral treatment or do provide an incentive for either one or the other area of investment.

Unless I were to conclude that they provide an incentive to invest abroad, I would have some question about their elimination. If I did find that they do, I would think a good case could probably be made for their revision.

Senator PACKWOOD. You mentioned totality in terms of investment. The investment tax credit, of course, does not apply to overseas investments. That is, therefore, a positive inducement to invest in this country.

Mr. BLUMENTHAL. Correct.

Senator PACKWOOD. This is a positive inducement to invest in this country?

Mr. BLUMENTHAL. Correct.

Senator PACKWOOD. If you were looking at totality and those are tax devices that induce you to invest in this country in terms of totality you may have to have some favorable benefits to incur to reach neutrality.

Mr. BLUMENTHAL. All of these factors, both those intended to be particularly beneficial to investing here as against abroad would have to be taken into consideration in such a review.

Senator PACKWOOD. Thank you very much.

I have no further questions, Mr. Chairman. Thank you for letting me ask them now.

The CHAIRMAN. Senator Griffin has entered on the scene. He would like to say a word on behalf of Mr. Blumenthal.

STATEMENT OF HON. ROBERT P. GRIFFIN, A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator GRIFFIN. Mr. Chairman, I just wanted you to know that the pride of Michigan in the nominee who is before you is bipartisan. We are very happy and pleased that Mike Blumenthal has been nominated by the President-elect to be the new Secretary of the Treasury, and I can tell you from a good deal of experience that he will be an excellent one.

We are very happy. I will not bore you or fill up the record with more recitations about his accomplishments. He is a very remarkable person, with a very distinguished record both in government service and in the business world.

I commend him to the committee, and along with my colleagues, Senator Riegle, urge that the Senate confirm his nomination.

The CHAIRMAN. Thank you very much.

Next on the early bird list is Senator Byrd of Virginia.

Senator BYRD. Thank you, Mr. Chairman.

I welcome Mr. Blumenthal. Mr. Blumenthal, what do you regard as the most important problem facing the Nation today?

Mr. BLUMENTHAL. The most important problem facing the Nation today on the economic front, Senator, is to provide for growth without inflation adequate to put the people to work who are able to work and looking for work and unable to find it; to do so, however, without inflation and in a manner which leads to that growth in the economy that can bring us at the earliest possible date a balanced budget.

Senator BYRD. Well, some—perhaps I should say at least one—feels that the most important problem is the need for the Government to put its own financial house in order. What order of priority would you list that?

Mr. BLUMENTHAL. I think that we cannot have prosperity and growth and stability if the Government's financial house is not in order. I really think, Senator, that these matters are really closely interrelated. One cannot be done without the other.

I think and hope that the economic programs that are developed are of a nature that all these matters need to be attacked jointly.

Clearly, Governor Carter has stated that it is his goal to achieve a balanced budget within a period of time. Clearly that is not possible this year, or next. He has assigned a very high priority to that task. I fully concur with that as a very important goal.

I think the other goals of keeping inflation declining over the years and providing employment for people have to be looked to together as a part of this three- or four-pronged attack on our economic problem.

Senator BYRD. Do you regard the proposed economic program which the Carter administration has indicated that it will send to the Congress to be a deflationary one? You do not contend that; do you?

Mr. BLUMENTHAL. I regard that program as a necessary step and a vital step in the direction of achieving, at the earliest possible date, the goals to which I have referred.

The reason that we have a very large budget deficit as this administration takes office is because, in large measure, the economy is operating at too low a level of capacity; that kind of shortfall is in large measure responsible for the big deficit.

As we achieve, hopefully through the program that is being recommended to the Congress, a faster growth rate, and receive the fiscal results of that, then I would expect that certainly the intention would be to bring us a balanced budget and stability within a period of time.

Senator BYRD. How much will the proposed economic package increase the projected deficit for 1977 and for 1978?

Mr. BLUMENTHAL. The precise program has, of course, not been fully defined, Senator. The estimates of the program as they presently stand and as have been discussed by Governor Carter with congressional leaders last week, provides for expenditures in fiscal 1977 of somewhere in the area if $12 billion to $16 billion, in actual amount probably around $15 billion, and for expenditures in the following year, fiscal 1978, at a level somewhat below that.

What we do not yet know and have not been able to calculate with precision, is how much of a return in terms of increased taxes and benefits from an economy that operates at a higher level of activity will be flowing back, so that the net addition to the deficit in 1977, and certainly in 1978, would be significantly smaller than the growth numbers. For 1977, there will not be time for enough of that net factor to play a role, but it should play an important and significant role in 1978.

Senator BYRD. My time has expired; I would like to explore this more fully at a later time.

Mr. BLUMENTHAL. Yes, sir.

Senator BYRD. Thank you, Mr. Chairman.

The CHAIRMAN. I am going to pass, at this time, and turn to Senator Hathaway.

Senator HATHAWAY. Thank you, Mr. Chairman.

It is a pleasure to see you again. Let me ask you two or three questions.

The Treasury Department, as you know, is responsible for insuring the compliance of financial institutions which hold Federal contracts with the Executive order prohibiting discrimination. GAO and the Senate Banking Committee have found that Treasury, in the past, has not done a very good job in this regard.

With your fine record at Bendix, I would expect that you would make a commitment to improve that record. Is that true?

Mr. BLUMENTHAL. Senator, my views on the necessity for all citizens to have equal rights and the importance of the elimination of discrimination, I think is clear. I feel very strongly about that. I am not familiar, frankly, with the precise rules and regulations that the Treasury has to administer. I will look at those very closely.

I will assure you I will do all that I can to make sure that they are properly, fairly, and clearly administered.

Senator HATHAWAY. Thank you.

At the beginning of this week, the Office of Revenue Sharing published in the Federal Register some interim final regulations under the recently enacted Revenue Sharing Act. We have received some complaints from public interest groups, as well as State and local government representatives, with regard to these interim regulations.

For example, I think there is some provision for waiver of the public hearing requirement, which the public is very much interested in.

On the other hand, there are some very stringent audit requrements which State and local governments have some interest in.

I wonder if you intend to go over these regulations and do you contemplate any additional consideration of these regulations before they come out in final form?

Mr. BLUMENTHAL. I will make it my business, Senator, to look at these regulations, go over them, and review them, to see whether I find them adequate or whether I would recommend any changes in them.

As to the question of public hearing, I believe with Governor Carter that the most open possible government, the most participation possible by the public in all of these matters is in the public interest. I would always stress that.

Senator HATHAWAY. I am glad to hear that. That is one of the most important parts of the revenue-sharing bill that was passed. We eliminated the laundry list of requirements for spending and substituted in lieu thereof public hearing mechanisms where the public itself could come in and testify as to what it wanted.

The last question that I want to ask you concerns trade policy. As you probably know, the International Trade Commission has recently determined injury in the shoe industry resulting from imports and has recommended tariff quotas to take care of the problem.

This, of course, will come before the President to make a decision of whether to go along with that recommendation or not. Undoubtedly he will be calling upon you for your recommendation.

Could you say at this time whether you would recommend going along with the majority decision—four out of the six Commissioners recommended tariff quotas.

Mr. BLUMENTHAL. I am really not in a position, Senator, to give a firm view today of what my recommendation would be. I would certainly note the fact that four out of six Commissioners have found in a certain direction. I would want to look closely at all the facts, the employment effect, the impact on the domestic economy, and on our international relations and international economic situation as I make my recommendation.

I am keenly aware of the fact, through 4 years of trade negotiations during my previous period of Government service, that the impact on employment on particular industries in the domestic economy is a vital factor in making these decisions. I would want to study them very carefully.

Senator HATHAWAY. My time has expired. I will ask more questions later.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. Mr. Blumenthal, it is hardly necessary to say that your nomination arrives at a time of serious economic difficulty. The economies of the United States and other industrialized nations are slowly recovering from the first concurrent world recession since 1957 and the most severe economic recession since the 1930's. Here in the United States unemployment continues at 8.1 percent—an intolerable level. Economic recession of this severity—combined with the threat of continuing inflation—is seriously straining the world's systems of trade and finance.

There is little that can be achieved if our economy continues to stagnate. On the other hand, there is much that can be accomplished for ourselves and our friends if the economy of the United States is strong and healthy. Accordingly, your task as Secretary of the Treasury will be to devise a policy to accelerate the recovery of our economy, without inflation.

The international economic problems facing us are equally serious and potentially disruptive. We live in a world of scarce resources and growing economic interdependence. It is appropriate that you are trained as an international economist. As the structure of the world economy changes rapidly we as a nation must learn to live with the problems forced upon us by international economic realities.

You, as Secretary of the Treasury will have to devise policies to help us survive and prosper under increasingly difficult circumstances. There has been a fundamental shift away from the traditional issues of foreign affairs toward economic issues and the strategies of ecopolitics. We have to have a coherent global economic strategy to deal with all the challenges facing us—including the potentially devastating effects of a powerful oil cartel. But most importantly, the United States must provide leadership. As our economy recovers and our international economic structures adjust to the new realities, America must be in the forefront of interdependent cooperation.

So, Mr. Blumenthal, I welcome you here this morning and I welcome your return to Government. We need a man of your intellect and ability at Treasury if we are to provide the political and economic leadership this country and the world so urgently require.

Now, Mr. Blumenthal, an amendment to the Tax Reform Act of 1976 denies tax benefits to any person who participates in, or cooperates with the Arab boycott or any other unauthorized international boycott.

President-elect Carter took a strong stand on this importance of this issue, speaking out on it time and time again during this last campaign.

With regard to the enforcement of antiboycott legislation, he said on October 18, "I believe that there must be effective implementation of antiboycott laws by the executive branch. I would make sure that the Government applies these laws vigorously."

Now, the Treasury Department has issued proposed guidelines on this law that to me and to other thoughtful people are totally unacceptable. In my opinion, the proposed guidelines do not seek to implement the law. They seem to obstruct and frustrate the legislative intent.

Mr. Blumenthal, as Secretary of the Treasury, I am interested in your views on these issues, particularly in whether you would order a complete review of the Treasury guidelines?

Mr. BLUMENTHAL. Senator Ribicoff, may I say at the outset that I am completely opposed to these sorts of boycotts. I agree with, and support, and welcome, the Ribicoff amendment that became law. I will most certainly, immediately upon taking office if I am confirmed, review these draft regulations to insure that they do, in fact, carry out the intent of this law and seek to administer them in a way that is consonant with the intent of this legislation. I do not believe in that type of boycott activity. I do not believe that Americans should support it.

Senator RIBICOFF. Mr. Secretary, the domestic and international economic problems that you will face as Secretary of the Treasury are very much inter-related. The paradox of unemployment and rising prices threaten the economy of our Nation and the industrialized countries as well as the world situation of trade and finance.

The recovery of the domestic economy cannot be separated from the recovery of the world economy. The recovery of the world economy is a function of the price and supply of energy. The supply and price of energy and other resources are related to the North-South dialog.

You are going to be confronted, as Secretary of the Treasury, with a seamless web of economic problems. I wonder if you could relate to us how you look upon your priorities, and which of these problems will receive your earliest attention?

Mr. BLUMENTHAL. Senator, you are quite correct, and I agree that these problems of the domestic economy, energy policy, world energy problems, the impact of these on the world economy and the North-South dialog are closely inter-related questions. It is difficult to assign priority to any one of these matters.

I would say the first thing we must do is to take the necessary steps to put our own domestic economic housei n order. We need a growing, healthy, vibrant U.S. economy, and that is a prerequisite for virtually everything else that we must do.

As a part of that, I would strongly feel that the development of a national energy policy should require high priority and I understand that that is something the President-elect intends to press strongly.

At the same time, with our current energy policy and our domestic economic policy taking shape, based upon the proposals that Governor Carter has made, we are now in a position simultaneously to talk to our friends and trading partners, in Europe, Japan and elsewhere and resume the North-South dialog on a basis which will allow us to talk sensibly and urge them to collaborate and do their part to put the whole world economy into better shape.

Senator RIBICOFF. Thank you.

The CHAIRMAN. Senator Talmadge?

Senator TALMADGE. Thank you, Mr. Chairman.

Mr. Blumenthal, it seems like old times to have you back before the finance committee again. You are familiar, of course, with former President Kennedy's seven point program of assistance to the American textile industry, including the short- and long-term arrangement relating to imports of cotton textiles, are you not?

Mr. BLUMENTHAL. I am, indeed.

Senator TALMADGE. That program has remained as the basis of textile trade policy through succeeding administrations. Now, however, that trade policy, as you know, is subject to the terms of the multifiber arrangement negotiated in GATT in 1973.

You are familiar with the multifiber arrangement, of course?

Mr. BLUMENTHAL. Yes, sir.

Senator TALMADGE. I was interested to read some time ago your comments on unemployment. As you know, textile imports and garment imports at the present time are displacing some 250,000 persons. That is rising right along.

You probably know that the multifiber arrangement is scheduled to expire at the end of this year.

In this regard, one of my constituents in Georgia, who is interested in textiles, visited with President-elect Carter. President-elect Carter wrote him a letter on his interest in textiles. I have shown you a copy of that letter.

You fully support President-elect Carter's comments on continuing the textile policy, I take it?

Mr. BLUMENTHAL. I do.

Senator TALMADGE. I ask unanimous consent, at this point, Mr. Chairman, that President-elect Carter's letter be made a part of the record.

The CHAIRMAN. Without objection, agreed.

[The letter to be furnished follows:]

JIMMY CARTER PRESIDENTIAL CAMPAIGN,
Atlanta, Ga., March 22, 1976.

Mr. MORRIS BRYANT,
President, The Jefferson Mills,
Jefferson, Ga.

DEAR MORRIS: Thoroughly enjoyed our meeting last week with Mr. McKissick and Mr. McLendon.

As you are well aware, I realize the United States has the world's largest textile industry employing about one million people. Some two thirds of the jobs in textile manufacturing are in small non-metropolitan areas. But combined with apparel production which provides another 1¼ million jobs it also is extremely important to the large urban centers. And its *minority employment* is highly significant—16% as compared to 11% in manufacturing generally.

Equally significant is the fact that jobs are provided in every state in the union either directly or by suppliers in agriculture, fiber production, chemicals, machinery, paper and many others.

Because it provides vast employment opportunities and because of its total economic impact special policies regarding international trade and textiles have evolved. These were initiated by former Secretary of State, Cordell Hull under the administration of Franklin Roosevelt in 1935. Today they are embodied, in a large part, in an international arrangement negotiated in 1973 under the auspices of the GENERAL AGREEMENT on TARIFF and TRADE—an arrangement which provides for orderly trade in textiles and apparel. This and previous international agreements have proved themselves beneficial to both developing and developed countries.

As President, my administration will continue and where necessary improve upon this policy which has been and is designed to preserve American jobs.

Once again thanks for your active support of my campaign. I hope that I will never disappoint you.

Sincerely,

JIMMY CARTER.

Senator TALMADGE. Do you realize in this critical time it is vitally and absolutely necessary for us to expand and continue our exports in every way we can. To that end, you will utilize the Export-Import Bank to the fullest degree, I take it?

Mr. BLUMENTHAL. I will.

Senator TALMADGE. As between agricultural products and industrial products, there will be no discrimination?

Mr. BLUMENTHAL. I will certainly see to that to the largest extent possible, in accord with all of the existing laws and regulations. I think that we ought to use our advantage wherever we can, and agricultural imports are one of the strongest factors in the import-export picture.

Senator TALMADGE. Thank you very much. I have no further questions.

The CHAIRMAN. We will call on Senator Hansen.

Senator HANSEN. Thank you, Mr. Chairman.

Secretary Blumenthal, a little less than 2 years ago you were testifying before the Senate Interior Committee on an energy policy. I read carefully what you then said.

Without burdening the record, if you can, recall the thrust of that testimony at that time. I would ask if you still hold to those views that you expressed then?

Mr. BLUMENTHAL. I recall them in only general terms, Senator, and I know of no major aspects of it regarding which I have changed my mind.

Senator HANSEN. Fine.

I am certain that we are all most hopeful that there can be further progress in the various negotiations toward peace in the Middle East. We should note particularly the actions taken by Saudi Arabia in refusing to go along with some of her sister countries in OPEC and holding the price increase to 5 percent rather than 10 percent that some have adopted. We should note, too, that the latest figures disclose that we are importing 41 percent of the oil that we use daily in the United States from abroad. I think about half of the oil that is imported into the United States now comes from Arab countries. Do you foresee any significant danger or threat to our continued energy supply, indeed, to our national security, if we were to modify in any significant regard the boycott terms that have been spelled out by Treasury regulation?

I refer, of course, to the question earlier asked by my good friend from Connecticut, Senator Ribicoff.

Mr. BLUMENTHAL. Senator, I think that the United States should never be afraid to speak clearly in a measured way on a matter that we feel strongly, for reasons of our history, our culture, and for reasons of law and equity. I think that is very important.

I think that if we explain that to other nations in a friendly and firm way that they will respect us for it.

I obviously do not favor precipitous action on any matter that would endanger the national security of our country. I think that this particular matter to which I responded in reply to Senator Ribicoff's question is one that has other complex issues attached to it that must be taken into consideration and no doubt will be. I really do not believe that it is necessary for us to compromise on the kind of approach that the President-elect has outlined, which is basically that the United States cannot and will not comply with boycott requests of the kind that are covered in the Ribicoff amendment.

Senator HANSEN. I do not argue with the position taken by the President-elect, nor do I argue basically with what you have said.

I think whatever the contention of Treasury in the present administration, that the thrust and the main thesis that was spelled out in conference between the Ways and Means Committee and the Finance Committee has been reduced to regulations by Treasury.

How might a significant revision of those regulations be interpreted by our friends around the world, indeed, by many of the companies that would be directly affected here if it were to be spelled out, or if the impression were to be left that they were not satisfactory?

You are not saying that they are unsatisfactory?

Mr. BLUMENTHAL. I am not saying that. I am saying that the commitment that I feel that I made, and I made it willingly and happily, is to immediately review those regulations to see whether they comply with the intent of Congress. I consider that to be my responsibility, and I will do so.

Senator HANSEN. Thank you, sir.

Thank you, Mr. Chairman.

The CHAIRMAN. Next, on behalf of the committee, I am happy to welcome our new member, Senator Schmitt from the State of New Mexico, to our committee.

Senator SCHMITT. Thank you, Mr. Chairman and members of the committee. It is good to be here. I am afraid it may be temporary, but I expect to learn a great deal from you and witnesses such as Mr. Blumenthal, and I have a soft spot in my heart for his previous association with Bendix, as I have used some of their equipment quite successfully.

I appreciate everything that your corporation did for us.

Mr. BLUMENTHAL. We helped getting you there and back, Senator.

Senator SCHMITT. Yes, sir, and you used about 4 hours of my time on the Moon that helped also.

I am a novice in the finance area. My questions will be fairly general.

I do know that the public in New Mexico, as elsewhere, are getting more sophisticated in the questions that they ask candidates about finance, so I suspect that my interest will continue in Congress.

I wonder if you could just discuss in very general terms for me, and hopefully for others, the relationship as you see it between the money supply and productivity in this country and inflation, and if that goes fairly well, add capital supply to that.

You have my 5 minutes to continue this discussion.

Mr. BLUMENTHAL. It is difficult to do that in 5 minutes, Senator.

I would say that I am afraid we do not know as much as we ought to about the causes of modern inflation, although there are many economists who will discourse eloquently on the subject. Also, it is a subject on which many people who are not economists have strong views, and although I once was an economist many years ago, I would have to say that I wish I knew and understood better the precise relationship among the causes of inflation as they are influenced by the money supply, as they are influenced by fiscal policy, as they are influenced by many factors that are decisive.

So I confess the limits of my knowledge. Second, what I do believe to be the case is that an economy that is managed in such a way—and I hate to use this phrase, but it is necessary to use it—other things being relatively equal, when the economy is operated with a supply of money in excess of the needs, and there is an unbalanced budget, then you clearly set in motion inflationary pressures. These inflationary pressures lead you into a lot of difficulties, they lead you to a lot of unemployment and hardship, and it seems to me that one of the major requirements of economic policy formulation and execution by the President and the Congress has to be to avoid that happening.

The next point that I would make, is that in my judgment you cannot look at any one factor and say that it is the sole cause of inafltion, and I would have some question about those who point to the money supply and money supply only as being the principal factor determining economic activity.

Clearly fiscal policy is terribly important. Clearly the budget is terribly important. Clearly the sum of the rigidities that exist within our society that make prices and wages not easily or quickly adjustable to underlying economic trends are very important.

We have had a situation where we have had inflation and high unemployment. That is not supposed to happen, according to the economists. That is what I mean when I say we really do not understand it fully and we have to do much more work and study on the subject.

So I look upon monetary policy as a very important aspect that requires a close working relationship in my new job, for example, with Dr. Burns, and I certainly look forward and expect to have a close working relationship with him. I will look upon that as one vital element.

But again, it is only part of a seamles web of interrelated problems that make up an intelligent economic policy.

Senator SCHMITT. You are not mentioning the word I mentioned, productivity. Would you care to discuss that from your previous experience?

Mr. BLUMENTHAL. I stand corrected.

I certainly feel that investment research and development and productivity, so that the resources that we have at our disposal are not only utilized fully, but efficiently, with an increasing level of efficiency, represents the only way that we can look forward to a rising standard of living. There is no other magic. Otherwise, we just shovel what we have around. The cake has to get bigger. The way the cake gets bigger is to do things more efficiently.

That is what business is all about. That is what any corporation worth its salt spends a lot of time and energy on. That is clearly a very important element for the economy as a whole.

Senator SCHMITT. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gravel?

Senator GRAVEL. Thank you very much, Mr. Chairman.

I would like to ask unanimous consent to have a statement inserted into the record at this time.

The CHAIRMAN. Without objection.

[The statement to be furnished follows:]

STATEMENT BY SENATOR MIKE GRAVEL ON THE PROSPECTIVE NOMINATION OF MICHAEL BLUMENTHAL AS SECRETARY OF THE TREASURY-DESIGNATE

I am extremely pleased that President-Elect Carter has nominated Michael Blumenthal to head the United States Department of the Treasury. Mr. Blumenthal brings to this office impressive credentials: proven successful leadership of one of America's major corporations and proven commitment and dedication to constructive efforts aimed at solving America's socio-economic problems. Jimmy Carter could not have chosen a more appropriate individual to work with him in the new administration.

I believe the Secretary-designate's experience to date will serve him well in:

Managing day-to-day as large an organizational structure as the Treasury;

In grasping the many complexities of national fiscal and monetary policies;

In working with this committee to effectuate revenue, budgetary, socio-economic and international economic goals.

I have already indicated my eagerness to work with him and with Jimmy Carter in these areas in what I foresee as a welcome, even propitious partnership for the Congress and Executive and to give immediate priority to matters such as a jobs program for reducing unemployment, and tax reductions and credits, short-term and longer, for our lowest-income citizens.

The Congressional Quarterly of December 18 in its detailed profile of Michael Blumenthal put it succinctly in stating that he will bring an "expertise in international economics, great success in the corporate world and enormous energy to this new job."

Senator GRAVEL. I would like to say I am very happy Governor Carter has selected Mr. Blumenthal as Secretary of the Treasury. My first question. As chief executive officer of a major American corporation, did you, at any time, encounter arrangements that you would classify as corporate bribery or commercial bribery, and what do you think can be done in the international community with respect to the conduct of businessmen involved in bribery and demands by Government for bribery, or whatever?

Mr. BLUMENTHAL. This is an important question and one that I have spent a great deal of time and thought on in my previous responsibility as chief executive officer of Bendix. It is a complicated issue, to which there are no simple answers.

I am proud of the fact that we have been fortunate that the policies that we developed for our company, for the Bendix Corp., have been faithfully observed by all of our executives in such a way that we have never been embarrassed to have to report publicly, as some other companies have, instances of illegal payments of bribery here or abroad.

What we did, essentially, was say to all of our people, and say it again, and again and again, and to institute internal procedures to insure to the maximum extent possible that this was understood and followed, that we do not believe that business that is obtained by methods that are illegal is worth having. We do not accept the adage of "when in Rome, do as the Romans do." We are a large company, we are an honest company. We would rather pass up some business than get that business by these questionable illegal means.

It took some time for my colleagues to realize that we were really serious. There was a lot of discussion and a lot of questioning, but we did manage to get that view accepted and it has not hurt the Bendix Corp. one bit. Our sales and earnings are higher than they have ever been.

I believe, and I have publicly said so, that it is possible for American corporations to adopt that approach. I believe that there is merit in exploring the notion of a code to which corporations in this country would subscribe, a professional code somewhat analogous to the medical profession, legal profession, or engineering profession.

I believe that that kind of leadership on the part of American industry would be welcome and would, in many instances, not only be admired, but followed by the industries of other developed countries. Indeed, we could reach some international agreements using our approach as a model.

That is not the only way of dealing with this problem, but it is one way, and one that I have suggested.

I believe businessmen are as honest, ethical, and as decent as other members of the society. I believe that the requirements of a complex world are different than they were 10, 20, or 30 years ago, and businesses have to adjust to it, and I would say that it is probably not a field in which I would welcome too much legislation.

It really depends on the individual actions of people as human beings. I would much rather see the business community voluntarily and on its own establishing standards of conduct and negotiating them internationally than to try to impose legislation which is difficult to frame and even more difficult to administer.

Senator Gravel. Thank you.

The Chairman. Senator Bentsen?

Senator Bentsen. Thank you very much, Mr. Chairman.

Mr. Blumenthal, in responding to Senator Byrd's question on the most important issue facing this Nation, you talked about the joint problems of unemployment and inflation and the difficulty of dealing with both at the same time. Much of what you try to do for one is counterproductive to the other.

I would like to speak for just a moment about my proposal for an employment tax credit to encourage business to hire additional workers. I would like to see a tax credit for investing in our most important resource, and that is people.

We have a recent econometric study that was made for the Joint Economic Committee by professors from the University of Iowa that shows that if a 5-percent employment tax credit with a 95-percent employment base had been put in effect in the fall of 1975 we would have more than 2 million people added to the payrolls today.

We had a similar study at Michigan State University which indicates that a marginal employment tax credit would have substantially decreased unemployment in this country. What we are seeking is a way of lowering business costs and passing these reductions on to the consumer and at the same time, putting people back on the payroll.

Since we have a competitive, free enterprise system, lower production costs from employer tax credits should be passed on to the consumer. It seems to me that an employment tax credit is one of the least expensive ways to try to put people in permanent jobs and not dead-end jobs.

I would like to ask if your office would make a study of this kind of proposal.

Mr. BLUMENTHAL. Senator, I know that one of the highest items on the agenda for priority consideration according to the wishes of the President-elect is the whole question of tax simplification and tax reform. I certainly intend to look at this particular proposal—I promise you I will do that. I am not familiar with the study to which you refer. I will have myself briefed on it, and investigate this as a possible way to achieve the goals that you have outlined.

Senator BENTSEN. Thank you, Mr. Blumenthal.

Another concern for me and for, I am sure, this committee, is the fact that the 1974 Pension Reform Act has a lot of overlapping jurisdiction between the Treasury Department and the Labor Department.

It has resulted in excessive paperwork and redtape.

Big business does not really complain much about this. They have the lawyers and accountants to comply with endless reporting requirements. However, it is often an excessive burden for small businesses. In fact, in some instances the administrative costs for a plan exceed the contributions to the plan.

I would urge very strongly that you help us resolve the jurisdictional disputes and cut back on the paperwork on that.

Mr. BLUMENTHAL. Senator, you touch a point that is very close to my heart. I would only differ on one small point: That is, your statement that big business does not complain. We complain bitterly at the amount of paperwork and the amount of bureaucracy that is required in these matters. If there is one thing I can do that will lead to simplification and elimination of these jurisdictional disputes that lead to more paperwork, then I would be delighted to do so, and I will do my very best.

Senator BENTSEN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Haskell?

Senator HASKELL. Thank you, Mr. Chairman.

Mr. Blumenthal, I am sorry I was not here when you arrived. I enjoyed talking to you very much today. I want to congratulate you for showing up without being flanked by a lot of people. You obviously do not need that kind of assistance.

I have one question.

We hope that our new administration will take the necessary stimulatory measures to the economy to reduce unemployment. It undoubtedly will occur to a lot of people that that raises the problem of inflation, yet it seems that people find that standby wage and price controls are an anathema. What are your views on the subject? Though we hope to stimulate the economy and reduce unemployment, we certainly want to control inflation.

What are your views on standby wage and price controls?

Mr. BLUMENTHAL. One of the worst experiences, Senator, that I had in my business career was to try to live with wage and price controls. It is an absolute nightmare for any businessman to try to live under because it freezes an existing pattern almost by definition, unfairly and capriciously, because you have to take a certain point in time and a certain reference period. It creates distortions in the economy and results in inefficiencies.

It is, in my judgment, a very, very poor way of dealing with what can be, sometimes, a very serious problem.

It is for that reason that I fully agree with those who feel that wage and price controls are not the answer except in periods of real national emergencies, certainly in war times, and such periods.

I do not believe wage and price controls are the answer. Since they are not the answer, I see no reason why they should exist on a standby basis.

What most likely can and will happen, if they do exist on a standby basis, is that businessmen, having been burned before, being slightly suspicious, would say to themselves, "Well, here they are, maybe they will activate them after all. And that leads, and can lead, to precisely the kind of inflationary raising of prices that would not otherwise occur.

I would be extremely concerned with standby controls having the opposite effect of the one you and I would want to achieve.

Senator HASKELL. Let me say that I hope that you are right, and I am wrong.

Thank you.

Mr. CHAIRMAN. Senator Nelson?

Senator NELSON. Mr. Blumenthal, several members of the Finance Committee are also members of the Small Business Committee, as you know. When the 1975 emergency tax reduction bill and the tax reform legislation of 1976 were before us, these members brought some proposals to the Finance Committee involving short-term stimulation and long-range tax reforms as they specifically affected small business and several of these proposals were considered by this committee, modified slightly, and adopted: estate and gift tax reform; increase on the surtax exemption from $25,000 to $50,000; reduction of the corporate income tax rate from 22 to 20 percent on the first $25,000 of earnings; an increase in eligibility for the investment tax credit from $50,000 to $100,000 on used machinery (the biggest user of which is the small businessman) improvements to "subchapters" of the Internal Revenue Code, and an increase in permissible accumulated earnings.

One of the complaints, and a legitimate one, I think, from small business is that the Congress and the executive branch hears the voice of the large corporation, because they have experts readily at hand, available to testify before committees or present their case to the executive branch; and of course, the small businessmen do not. And from my observation over 14 years, I think that is a valid complaint, whether it involves legislation on regulation or taxes in the Congress, whether it involves the drafting of regulations in the executive branch, the small business community does not feel that it gets a fair hearing. I think that is correct.

My question is general.

During the campaign, and afterwards, I believe, President-Elect Carter made some statements, respecting small business. One of them in response to questions presented by the National Small Business Association. Mr. Carter said, "As President, I will introduce and support concrete programs which would have as high priorty the expansion of the independent small business sector in the economy. Also, he stated: To measure the success of these programs, my administration would develop specific statistical yardstick formulas to measure the relative growth or small business in relationship to other sectors of the economy."

The Small Business Committee has been proposing that within each agency of the Federal Government—including the Department of the Treasury, of course, the Department of Labor and the rest—that there be some designated a representative of or contact point for small business. This would make it possible when regulations are drafted, that small business would have an input. The Small Business Administration would also be, able to consult with the representative, in order to have its viewpoint of the problem, and the proposed regulation and its impact on small business, considered before the regulation is adopted. As to tax changes, the same.

My general question is, would it be your intent, in terms of any recommendations that you had on tax policy matters, that you would specifically—or would you specifically consult the representatives of the small business community. Also, in the drafting of regulations—Senator Bentsen mentioned ERISA which, in the form of 16 of pages that could have been done in 5½, small business was not consulted. These form have been a disaster to many of them.

Would it be your established policy to call upon the small business community for their suggestions on taxes, regulations, and other such questions?

Mr. BLUMENTHAL. A short answer to that, Senator, is definitely yes. I do not necessarily believe that big is necessarily beautiful. I realize that there are many more small businesses than large ones in this country. In the kind of advisory groups that I plan to establish, or activate, or that already exist, I would certainly make sure that small business is particularly represented. In the staffing of the Treasury at senior levels, I also intend to pay some attention to that consideration.

Senator NELSON. This is their compelling concern, and over the years. Everyone who appears, who is asked that general question, of course, gives the answer "Yes," because there is no other answer. But, thereafter the implementation of a program, the establishing of an effective responsibility toward small business within the Agency never seems to get implemented.

What I am simply asking: Would it be your specific intent to implement a specific program of establishing a relationship with small business and all matters affecting them so that they would have an adequate hearing on their viewpoint before regulations emerged, or before the proposed tax reform package?

Mr. BLUMENTHAL. Yes, sir, I will consult with the Secretary of Commerce to make sure that we do not overlap, but work together, and it is my intention to set that up within the Treasury.

If I do not carry it through, I hope you will remind me.

Senator NELSON. Thank you, Mr. Chairman.

The CHAIRMAN. There are a number of Senators who would like to be here but are necessarily attending meetings somewhere else. I have a letter from Senator Moynihan. I would like the letter be printed in the record.

[The letter referred to follows:]

UNITED STATES SENATE,
Washington, D.C., January 12, 1977.

Hon. RUSSELL B. LONG,
Finance Committee,
Dirksen Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: I am one of the two freshmen who were chosen by lot yesterday to fill the Democratic vacancies on the Budget Committee, which I gather Ed Muskie thought was a matter of some urgency. That being the case, I assume I had best be on hand for the Budget hearings which begin at 10 this morning and so will not take advantage of your generous offer to sit with the Finance Committee while my old friend Mike Blumenthal is heard.

Respectfully,

DANIEL PATRICK MOYNIHAN.

The CHAIRMAN. In addition to that, Senator Proxmire sent over a letter proposing three questions which I would urge you to look at and see if you would feel that you could respond to those at this point, Mr. Blumenthal.

Mr. BLUMENTHAL. Yes, Mr. Chairman.

I have before me a letter sent by Senator Proxmire to you, and the first of three questions which he raises relates to bank regulatory reform. The question is, "Given President-elect Carter's interest in Government reorganization, will I give serious consideration to endorsing the concept of consolidating bank regulation within a single Federal agency?"

The answer to that, Mr. Chairman, is that I will certainly seriously consider it. I will have to confess that I do not, at this point, know all of the detailed considerations involved, but I know of the interest of Senator Proxmire and others in this matter, and we will, indeed, consider it seriously.

The second one relates to the New York City loan program and the question, Senator Proxmire's question, is what the timetable appears to be on this program, and whether or not I anticipate that any new initiatives will be announced early on in the new administration, or whether it is intended to wait and see how New York City progresses under its present financial plan.

Mr. Chairman, I have been in touch, as a result of the instructions of President-elect Carter, with the authorities and the interested parties in New York City to follow through on the President-elect's three points which he made at Sea Island.

The first is: He does not consider bankruptcy for the city of New York to be a viable alternative.

Secondly, that he is happy to see the progress that has been made in closing the current budget gap, and notes the commitment to close the gap for the coming fiscal year. He made the point that that is something that has to be done locally and that he expects will be done locally.

Similarly, the question of raising the funds related to the moratorium decision which exceeds $1 billion, that, too, has to be raised locally by the people involved in New York City, and that is another matter that he expects to be done there.

The third point: We will have to do a lot of studying and thinking regarding the question of insuring that subsequent to the coming fiscal year, subsequent to June of 1978, with a balanced budget having been achieved, that the city of New York would again be in a position, on its own, to have access to the financial market for the raising of its financial needs.

We will be working closely with them on that question. We recognize that the issue relates, really, not just to New York City, but perhaps more broadly to all the major cities of this country and that the timetable is to get started on studying the problem immediately, but I am not really in a position to say when any decisions would be proposed in regard to that matter.

The final question relates to the contract compliance program, and it is given the support—I think it is addressed to you, Mr. Chairman.

The CHAIRMAN. No; I think it is addressed to you.

Mr. BLUMENTHAL. "Given my support for affirmative action at Bendix"—that is right, at "Bendix"; it must be me—"will you make an effort to improve Treasury's record in this area?"

I most certainly will.

The CHAIRMAN. Senator Packwood, we are on the second round. You may have 10 minutes, if you wish.

Senator PACKWOOD. I do not need 10 minutes.

I am back, Mr. Blumenthal, because of the problem that the Rules Committee is addressing itself. The Rules Committee was unable to meet because they lacked a quorum because there were other members at the Foreign Relations Committee, so they will meet tomorrow at 10 o'clock, when we are here to consider Mr. Califano.

Two quick subjects. Indexing, indexing generally. What is your view about it? Indexing tax exemptions?

Mr. BLUMENTHAL. And making them conform to the rate of inflation?

Senator PACKWOOD. Yes; because of the argument the Government gets an unjustified windfall and people get pushed into a higher tax bracket because their income goes up, although it does nothing to keep up with a higher cost of living, but they are pushed into a higher tax bracket that has not been indexed.

Mr. BLUMENTHAL. I would have to study the matter more closely. Mr. general layman's reaction to a broad-based program of indexing throughout the economy would be negative. I would like the free market mechanism to work. I would not like to see business and the private economic unit tied in, locked in, in that way. It builds in automatic inflationary pressures in the economy. The whole question of productivity in all of these matters must be allowed to have its proper place.

As a general rule, a broad policy of indexing is, in my judgment undesirable and, I think, unnecessary, if we achieve our goal of a modest, declining inflation rate. That becomes a different matter when you have a high inflation rate, and that we must avoid at all costs anyway.

Senator PACKWOOD. The second question is fringe benefits.

Secretary Simon has just withdrawn a Treasury discussion draft about fringe benefits, such as free tuition to college employees, and parking spots for employees.

What is your general view? Airline rides for airline employees when the plane is not full, department store discounts, chauffeurs for people driven to work. What is your view as to whether these benefits that exist on a wide scale should be taxed as income? They have not been in the past. What do you think about it?

Mr. BLUMENTHAL. Senator, I will have to spend a little time familiarizing myself again with all of the various considerations. I really have no knowledge beyond what comes from the newspapers about this particular situation.

I think that is probably difficult, and perhaps unwise, to single out a particular area in a field that is very broad, under which there are many factors and many examples. They must be attacked together, particularly where there are all kinds of resulting hardships and problems that arise because the pattern has been in existence for a long time.

I would move cautiously. I will say that I will insure that there is a procedure within Treasury so that there can be close collaboration between Mr. Woodworth, Assistant Secretary of Tax Policy, and the incoming Commissioner for the Internal Revenue Service, so that they work closely together. They will report directly to me and work with the Deputy Secretary and we will look at those problems in their totality.

Senator PACKWOOD. As a quick aside, as president and chief executive officer of Bendix, did you have a chauffeur?

Mr. BLUMENTHAL. No. On weekends and so forth I drove my own car. But during the week I was picked up in the morning and taken home at night, and I worked in the car all the way.

Senator PACKWOOD. Thank you.

I have no other questions, Mr. Chairman. Thank you.

The CHAIRMAN. Senator Byrd.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Blumenthal, first I want to commend you for your statement to Senator Gravel in regard to the fact that your company, under your leadership, refused to pay bribes or other illegal payments in order to attract business.

I certainly agree with your viewpoint. Business itself can solve this problem, if it is willing to do so.

The Wall Street Journal of this past Monday on page 1 had this statement:

> The good news about the business outlook is that it has grown increasingly clear that the economy will keep expanding as the new year unfolds, very possibly with exceptional vigor. The bad news is that the danger of worsening inflation appears greater that at any time in some 3 years.

Do you agree or disagree with that statement?

Mr. BLUMENTHAL. 3 years goes back to 1974. That was the period when we had a very high level of inflation. I would not take 3 years. If I took 3 years as my base point, I might have some difficulty with that, Senator.

I do agree with the concern that is expressed that underlies the statement that we must now be very careful. We have a level of inflation that, in overall terms, is 5 percent, although there may be some underlying factors that could accelerate that, and therefore any economic program by the incoming administration must assure that inflation is not worsened thereby.

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I notice in the figures that were handed to me which were released this morning, some essentially bad news that indicates that the Wholesale Price index has risen more than it should, and clearly that is something to watch. I would therefore say that there is a clear need, as these policies to achieve a reduction in the rate of unemployment are put into place, to keep an equally careful eye on the level of inflation and prevent any acceleration from taking place.

Senator BYRD. I have the feeling that the greatest long term threat to the people of the United States is inflation. Would you comment on that observation?

Mr. BLUMENTHAL. Senator, I think that the greatest challenge is to protect the people of the United States from the negative effects of inflation and to provide a job for every American who is able to work, and who wants to work.

Senator BYRD. Your soon-to-be colleague, Mr. Charles Schultze, who will be the Chairman of the President's Economic Advisory Counsel, stated that the $30 billion stimulus proposal that would add as much as $15 billion or so to the deficit in the current fiscal year will not crowd private investors out of financial markets, if the Federal Reserve System follows an accommodative monetary policy.

Do you agree?

Mr. BLUMENTHAL. I agree.

Senator BYRD. What is "an accommodative monetary policy"?

Mr. BLUMENTHAL. I assume what Mr. Schultze has in mind—what I would have in mind—would be that we do not have a situation in which, as the economy begins to grow and expand, and the growth rate rises above the present level, and hopefully moves up closer to the 5½ or 6 percent that is required to reduce the level of unemployed, that as that happens, the money supply is not tightened in a way, credit is not tightened in a way, so as to prevent this from happening.

In that situation, competition for capital enhances the rising cost of money and could present problems, but I do not anticipate that will happen. I certainly intend to work very closely with Dr. Burns, with whom I have a very good relationship, and intend to have one, to insure that it does not.

Senator BYRD. You said in your response a moment ago, if interest rates are not allowed to increase; how do you envision that interest rates will not be allowed to increase?

Mr. BLUMENTHAL. I would not say that interest rates would not be allowed to increase. What I meant to say is that policies are not followed that result in the creating of a shortage of capital resources and a substantial increase in the rate of interest. I think the interplay of monetary and fiscal policy in that regard will be a very important factor. Ample supplies of capital are available at noninflationary rates of interest to finance the investment decisions that large and small business presumably will be making in response to the more buoyant consumer demand.

Senator BYRD. Is it correct that the more the Government goes into the money markets to finance the deficits, the greater strain there is on interest rates, the greater upward push there will be on the interest rates?

Mr. BLUMENTHAL. That depends, to some extent, on the state of the capital markets at that particular point in time. In a situation such as exists at the moment, where the economy is operating at a relatively low level of capacity, and the balance sheets of most corporations are very strong, and loans are down, and the banks are looking for borrowers rather than having a surfeit of them, then the chance of the Federal Government financing the kind of program that has been proposed and thereby crowding out the private investor appears to me to be minimum.

Of course, during other periods when loan demand is already very high, when we are operating at a high level of capacity, that could be a problem, and therefore, one has to look at the particular point in time to make the decision.

Senator BYRD. You hope that there will be a high level of private activity. That is what you are aiming for?

Mr. BLUMENTHAL. Right.

Senator BYRD. At the same time, you are proposing to increase the deficit?

Mr. BLUMENTHAL. I think that is a question of sequence, Senator. We are starting out at a point in time when the level of activity is too low.

As the program begins to take hold and the economy begins to operate at a higher level of activity and private industry makes its investment decisions, the budget deficit is expected to come down substantially and the activity of the Federal Government in the market would be reduced.

Senator BYRD. Let us get to some figures now.

The projected deficit for the current fiscal year is $50 billion as a minimum. The contemplated program will increase that $50 billion by how much?

Mr. BLUMENTHAL. I cannot give you a precise net figure, but assuming that the stimulus in fiscal 1977 is in the range of $12 to $16 billion, it will increase the deficit by that amount, minus a small flowback of maybe $1 or $2 billion.

Senator BYRD. Increase it roughly $12 to $15?

Mr. BLUMENTHAL. If the program is between $12 and $16 billion, we expect $1 to $2 billion to flow back. The net increase to the existing deficit will be $11 to $15 billion, or $10 to $14 billion, in that range.

Senator BYRD. The budget deficits in fiscal year 1975 and 1976 total $109 billion. What you are saying is that those deficits are not enough. We will have another $50 billion this year. That is not enough. We have to add to that if we are going to get additional activity.

Is that what you are saying?

Mr. BLUMENTHAL. I am saying that the Carter administration will inherit a budget deficit which in any case will be $50 billion and may well be somewhat higher, and that a large part of the cost of that deficit is the fact that we are operating at a very low level of economic activity. In order to get out of that situation, a further program now seems to be the best way to get the budget deficit down next year and in subsequent years.

Senator BYRD. We will need to pursue this in a little more detail.

Mr. BLUMENTHAL. Yes, sir.

Senator BYRD. Thank you, Mr. Chairman.

The CHAIRMAN. I see my time has rolled around again.

Mr. Blumenthal, let me commend you for the proposal that you have in mind in regard to simplifying the tax returns of the great majority of American citizens. I have no doubt that that will be very good news to those who file their income tax this year. Regretfully, this year it is going to be more complicated than it was the year before, and that has been the trend for some time now.

I suspect that as you pursue your goal of tax reform with simplification being one of the prime objectives that President Carter and you have in mind, you will find that it will be more desirable, as time goes by, to encourage people to use the short form, rather than the complicated form where they attempt to itemize all these various proposals.

I hope that you, with the able assistance of Mr. Woodworth—and there is no greater sacrifice that we could make than to give you our best man on the Hill—that you will find ways to encourage people to use the short form rather than the long, itemized form. That means that you will have to make it more attractive to use the short form and less attractive to itemize.

I would urge that you take a look at what this committee at one time recommended back in the 1960's, when we tried to give an option to people who make more than $20,000 to waive the opportunity to itemize and claim individual deductions. In return for that, they would pay at a lower rate than they would otherwise pay. I think that was called by some the "long short form" at the time.

While you may not like all the details about it, I would commend it to you as the approach to go along with tax reform. I would hope that we could get to the point where 95 percent of the people of this country would take the simple approach with a standard type deduction, rather than itemize and go through all the computations that might be involved. I assume we will repeal some of the deductions presently there. I doubt that you will find a way to make it simpler for everybody.

These laws are complicated because some people want it that way. When taxpayers came and asked that we consider their problem, sometimes we gave them favorable consideration. In due course, we found that in some cases there was too much of a good thing, and then we proceeded to amend the law to take away some of the advantages that people had been able to enjoy.

Most of the people who complained the most bitterly about the complications are the people who asked that it be that way to begin with. I would hope that as you study this, you could suggest to us a series of recommendations so that those people who do not want to pay taxes in the difficult, complicated way that we have for them now, would have a much simpler option available to them. I would hope that that would apply all the way up and down the line, not only to those making less than $20,000.

Mr. BLUMENTHAL. Mr. Chairman, I have always supported that goal. I am happy to hear from the experts, including Larry Woodworth, that the first proposal along that line that has been made would, in fact, raise from 69 to 74 percent the number of people who are likely to file short forms using the standard deduction, and I think it would make me happier to move that up substantially.

Nothing particular would make me happier than being in a position at some point to be able to use that kind of short form instead of having to hire lawyers and auditors and others to tell me how to prepare that complicated form I now have to prepare.

The CHAIRMAN. There are a lot of people who are willing to pay more if you relieve them of the burden of all the complications involved. If we could provide them that option, I think that it would be a popular thing for all of those who use it, even though in some cases it may cost them a little more.

Senator Hathaway?

Senator HATHAWAY. Thank you very much, Mr. Chairman.

I just have one brief question.

Mr. Blumenthal, would you favor including the Internal Revenue Code in the so-called Sunset legislation so that the Internal Revenue Code terminates on a periodic date and we would be forced to review all of the provisions thereof? This has been advocated for every other piece of legislation that comes before us.

Mr. BLUMENTHAL. Senator, I really must confess that I do not have a view on that. I know we are going to be beginning a total review of the tax code for fundamental tax reform and simplification in that regard. No doubt, we will be looking at the total code. Whether that ought to be made a regular requirement, I would want to look into it before I give you a more considered answer.

Senator HATHAWAY. A second question along that line; do you have any particular views with respect to tax expenditures versus direct expenditures?

As you well know, we spend a lot of money for social and economic problems with the so-called back-door Internal Revenue Code. Many of us have advocated that these programs should be funded on a direct appropriation basis rather than through the Internal Revenue Code.

Mr. BLUMENTHAL. I think, wherever possible, that that is desirable. I think that it will be some time before that will be entirely eliminated. I regard it the major purpose of a tax code, a system of taxation, as the raising of revenues and insuring that the taxpayers voluntarily pay what they have to pay. But I also understand that you cannot devise such a code, and achieve such a code, without bearing in mind certain social and more general objectives that are a part of the society.

I would regret it if the tax code got twisted and turned too much toward that end, and therefore began to have a negative impact on the major objective, the raising of the necessary revenue, and having people complying with that voluntarily and being able to understand what they are doing.

Within these two considerations, I would certainly hope that we could move somewhat in that direction.

Senator HATHAWAY. Thank you very much.

The CHAIRMAN. Senator Ribicoff?

Senator RIBICOFF. Mr. Blumenthal, on December 2, 1976, Treasury proposed regulations, which if made final, would alter the tax treatment of tuition programs. Under current regulations, various kinds of free tuition programs available to children of college and university employees are deemed to be nontaxable scholarships.

This has been the view of the Treasury and Congress since the first tax law was enacted in 1913. The proposed regulation would treat the value of these scholarships as income and result in further tax being imposed on 1,000 of individuals. This is contrary to what has been the congressional intent.

I do not expect an answer from you on that subject. I would ho that you would have the Treasury staff review these propos regulations.

Mr. BLUMENTHAL. I will certainly do so.

Senator RIBICOFF. Mr. Blumenthal, I have found in my experien in Government that one of the great problems to providing Americ leadership toward international economic cooperation has been t continuing prickly relationship between the Treasury and State D partments. This is tragic.

Within American leadership, you have no worldwide leadershi You cannot talk to a leader in private banking, private industry government in any country in the world, be it developed or underd veloped, without their telling you that without American polic there can be no policy. Everyone acknowledges the importance Ame can leadership.

I would cite three examples. Last spring, Chairman Long asked n to accompany Secretary Kissinger to Nairobi at the UNCTAD Co ference. There I watched with dismay the cables back and forth ar conversations between Treasury and State to allow the Secretary State to speak for the United States in that supposedly importa Conference on what policy would be.

Secretary Kissinger was not able to finalize his proposals until abo 7 o'clock before the morning he was to make his presentation. The Se retary made some good proposals, but he was not able to clear it wi anyone in the developed and underdeveloped countries. Consequentl it was a dud, when the whole world at that time was looking for Ame ican leadership.

In the field of energy, over the last few years I have made a nun ber of studies at home and abroad. Here again, from oil-producin countries and oil-consuming countries, the whole world is waiting f an American energy policy. Without an American energy polic there cannot be a world policy.

At one period of time in Paris, Secretary Kissinger had the conce of indexing prices with the inflationary factors. Secretary Simon wa dead set against it, and consequently it fell between the stools.

In my recent visit to the Middle East, various oil ministers talke about the absolute necessity for the consuming and producing cour tries to have a continuous dialog on the role of energy and energ pricing, on the impact internally and externally on their economi and world economies. Yet, without leadership from the United State nothing takes place. So the problems we faced just a month or so ag with the OPEC countries is in large part due to our failure to brin together the consuming and producing countries.

I am in the process now of conducting an ongoing study of inter national organizations. The United States contributes—and I thin my colleagues would be surprised—some $1,200,000,000 to various in ternational organizations. These international organizations hav American representatives at all of their conferences and meetings. am amazed as the study develops that again there is no leadership.

The American representatives at these conferences do not have th slightest idea what American policy is. The Soviet Union knows be forehand every time what Soviet policy is. The underdeveloped coun tries get together, they know what their policy is. They come to these nternational conferences looking to the United States to project a rogram and policy. The United States does not have one.

No one knows at any given moment who speaks for the greatest ountry in the world, the United States. The answer is, nobody.

Here we have a basic problem. The world's leading nation is supposed to, but is not, leading. This is because of problems of human ealousy, human one-upmanship, bureaucracy, fights for prestige by nen who head up departments and speak for the United States.

I know you, I respect you, I like you. I think that you are a very speial and able man who has got a lot to offer. I watched you in the Kennedy Round, when you were special trade representative. You nderstand these problems.

From your experience in Government and business, how do you proose to coordinate with Secretary Vance, with the Special Trade Repesentative that the President will ultimately appoint for confirmaion by this committee, with the Secretary of Commerce, with the Secretary of Labor. How do you see the executive branch being organized so that there will be an American policy in the entire interational economic field?

Mr. BLUMENTHAL. Senator, I believe with you that we cannot escape, s a Nation, the responsibility for asserting our influence and our leadrship, particularly with our friends and allies and in negotiations vith others, whether we like it or not. We are a large and strong counry and we have to play that role.

There are two ways to organize the Government to insure that his be done. I have no doubt that it will be done in the incoming dministration. Indeed, the work has already proceeded to insure that t is done.

One way is simply the organizational structure that is created to nsure timely and effective coordination of differing views and the stablishment of a timely policy that all members of the administraion and all Cabinet members can know, understand, and support.

The second is the individuals that are chosen to fill these jobs and o work together. With regard to taking the second form first, I am mpressed by the fact that Governor Carter, by selecting not only people for the Cabinet, but also in instructing us on how to recommend to him the people who are to be recruited for the sub-Cabinet jobs, has had very much in mind the need for building a team that can work together.

In the particular instance that you mention, the Secretary of State designate, Mr. Vance, and I have been friends and colleagues for a good many years, and we have collaborated together on many private endeavors. We know each other well. I have no doubt that there will never be any kind of personal problem, or problem of jealousy between us.

Similarly, the people who are being recruited to staff the next level, Mr. Cooper in the State Department, and others who will be coming nto the Treasury, are going to be people who are going to be looked t from the point of view of whether they can work together and whether they can be team players.

From everything I see—and everything I say applies also to Mr. Schultz, whom I have known for many years and have a good working relationship with—I think that the personality of the people, the way they operate, will be good assurance that we can and will work together.

The second point relates to organization. There have been many studies made, studies of the way in which the coordination for economic and international policies have been worked out in the past, and we have tried to learn from the mistakes of the past.

What is likely to happen is the creation of a single economic policy group, a relatively small group that will have on it not only the Secretary of State, Secretary of the Treasury, but also the Chairman of the Council of Economic Advisers and the Director of OMB, as well as the Secretaries of Labor and Commerce, and we will have participating equally the Special Trade Representative, and the Energy Coordinator who will have interest in particular programs. A simple method of review, coordination and development of policies will be implemented through that body, both of domestic and international programs, given the close interrelationship between the two.

Through my participation on the National Security Council, I will have an opportunity to play a full role in watching the relationship between political and economic problems. It is therefore through this mechanism that is being created and through the choice of the people that have been selected that I think we have a good chance to correct some of the problems that you have explained.

Senator RIBICOFF. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Talmadge?

Senator TALMADGE. No further questions, Mr. Chairman.

The CHAIRMAN. Mr. Hansen?

Senator HANSEN. Mr. Blumenthal, several questions have been raised about how we can help come to grips with unemployment. The figures I have seen indicate that those persons between the ages of 16 and 24 constitute roughly one-fourth of the total labor force, and within that same age group, 16 to 24, are found about one-half of the people presently unemployed.

What role do you believe an examination of the impact minimum wage laws, child labor laws, and unemployment compensation would have on the unemployment picture. As you know, under certain situations within a State, unemployment compensation benefits may be extended for as long as 65 weeks. Can training programs put on by business compete with that benefit system?

I would add one further subject—the union restrictions on apprentice programs. I understand that in some unions five journeymen are required to merit one apprentice program.

Are these all problems, or all issues, that should be looked at as we try to solve the knotty problem of unemployment, particularly these people constituting an important part of the younger age group?

Mr. BLUMENTHAL. I would certainly say, Senator, that none of the points that you have mentioned, none of the programs, or others that may come to mind, should be excluded from consideration and review to determine if they are fair, adequate, contribute to, or hinder the basic economic and social goals that we have in this country.

My answer would be yes, they should be looked at.

I believe that the problem of unemployment among the young is indeed a very, very serious one. I think that it is really totally unacceptable that a young person in this great country of ours who wants to work cannot find gainful employment.

I served for some years on the board of New Detroit, an organization of private citizens from all walks of life where we attempted to deal with the economic problems of that city. They are severe, with youth unemployment that runs, in certain age groups, as high as 50 percent. It is one of the critical problems that we face, and it leads to all kinds of serious problems, including crime, and all sorts of other things.

I believe that the particular program that is being recommended by the President-elect is one way of getting at the problem. It includes, among other things, some limited, carefully designed programs of a size that can be carefully and well administered, not with a buckshot approach, but a rifle shot approach, directed at specific age groups in specific areas. The kinds of young people you describe would be for certain limited periods of time put into perhaps a youth employment corps and taught useful skills, sent out to work, through the National Park Service, in doing the many useful and productive tasks in the national parks and elsewhere that can be done by them and learn a profession and trade in the process.

That is money that is well spent. It is money spent on the one hand; and it is welfare money, unemployment money saved on the other.

I think that clearly we have to be very careful about the cost of these programs. As these young people enter the labor force, we have to look at the wage rates that they will be getting to insure that the problem does not defeat the purpose that we have in mind.

I do not believe that we can solve the unemployment problem by generally lowering wages. I think productivity and research and development from business investment, is really where most of those jobs have to come from. Five out of six jobs in this country are private jobs. We do not want to start programs that would change that relationship and put more people permanently on the public payroll. I would strongly oppose that.

To create these private jobs for these young people really requires not a lowering of wages, or exempting certain groups from the minimum wage laws, I would think, but rather, it means programs under which research and development, private investment, incentives to create new jobs in a growing economy that brings us about are the prime goals that we will pursue.

Senator HANSEN. I appreciate your answer and I share your strong conviction that we ought not forget that five out of six jobs are found in the private sector.

With all due respect—and I have great appreciation for any idea that you may hold, Mr. Blumenthal—I must say that the thing that worries me about the kind of youth conservation type program to which you spoke is that it cannot involve enough young people.

Right today, it seems that many of the old laws that we have on the books are archaic. I think that the child labor laws have no meaningful purpose longer to serve. There was a time when there really was a very real need, as everyone knows, but you really cannot, I believe, coerce somebody into doing something that he should not be asked to do. so long as he is going to be able to eat and have a reasonably decent place to sleep.

As a consequence, I have a feeling that some of these laws are self-defeating. I happen to be a rancher. Lots of young people would love to come out and work on a ranch. But we have machines on a ranch, so generally speaking, they cannot come out. The only way they can work is if they happen to be a member of the family.

I have grandchildren who do work, who have been driving tractors since they were 10 years old. I happen to think that there is a lower incidence of fatal accidents on those tractors than there are in the kids in town who are not working at all, but driving around in somebody's hotrod and getting into the problems that young people do. I just happen to think that if we really want to expand opportunities markedly for young people that we need to make it a responsibility of the business community. Towns could play an important role in this as well.

We are not going to send any significant numbers of young people out to Yellowstone or Grand Canyon or Sequoia or some place else. It is a great experience. I share your enthusiasm for it, as far as it goes, but it does not reach enough young people.

Kids could be stocking grocery store shelves. It would not hurt them. Instead of Mom and Pop standing up till 12:00 o'clock at night to replenish the shelves on the stores. Younger people could do the job, and, if necessary, let them be paid a wage below the minimum wage.

When I was Governor of Wyoming, I recommended raising the minimum wage. It was Pat Moynihan who told me later on, as a member of the Finance Committee, that minimum wages militate against people with fewer job skills and minorities getting work, and I think he is absolutely right. I would suspect, as we raise the minimum wage, that we are going to find these groups of people harder pressed to find work than they are today. If we had some way of making an exception for people who need training, the best training of all is training on a job that they might later on be doing. I do not think they have to be sent away someplace. If we could encompass within a revision of the law the concept that this is the kind of job training that is going to make them useful, productive members of the work force who will earn more than the minimum wage, that is a real plus. I would hope that you might, if you share that view and to the extent that you are able, help it along. I think it is going to need a lot of help, because I am sure the unions and a lot of other people are going to be opposed to it. I think it has some merit.

Mr. BLUMENTHAL. Thank you.

The CHAIRMAN. Mr. Schmitt?

Senator SCHMITT. Yes, sir.

I would like to pursue one point and a couple of other questions on the Federal Reserve Board.

Do you have an opinion on how closely the term of the Board Chairman should be tied to that of the President?

Mr. BLUMENTHAL. I think that the independence of the Federal Reserve is a tried and true method of operating in this country. I have no particular views that that independence should be modified or changed. The changing of the term of office for the Chairman of the Federal Reserve would not be something that I would have any strong urge to recommend.

Senator SCHMITT. That is good to hear.

I would also like to follow up on what Senator Hansen has said, but again, taking it the next step: that is, we have a 16- to 24-year-old unemployed group that is now constituting over 50 percent of our total unemployed if our figures are correct. However, that is continually resupplied, and we can work with, and we should work with, and follow every available course that we can come up with that will work to teach these people jobs, find them jobs, whatever else is necessary. However, if we continue to supply that group with unemployable people, we continually have to take those kinds of steps.

Do you see anything in the purview of your office that would start to get at the core of the problem, the education system and maybe even the preschool period?

Mr. BLUMENTHAL. Let me say, in response to your question, Senator, and commenting also on the point made by Senator Hansen, that some of the specific ideas that Senator Hansen raised of course, first and foremost would fall in the purview of the Secretary of Labor and are not directly a part of my responsibility. And as I said, I think they all ought to be looked at.

Secondly, the example that I cited in regard to the national parks, I cited it because it happens to appeal to me. It is a good program. Clearly, it is not the only thing that needs to be done, because, as correctly pointed out, the number of people involved, as you reemphasize, is really much larger.

There are, in the proposal that the President-elect has made and will send to the Congress, other similar programs for apprenticeship training of various kinds for employment of these people in urban areas that will go alongside the particular one I mentioned and make a somewhat larger dent into this large pool which, as you say, is constantly being replenished.

I would hope that in the course of the more fundamental tax review and reform and simplification that will be undertaken that we can bear in mind the particular problem that you raise. I think that it is frequently the young people of this country that get the short end of the stick.

As a developed society, the people who have political power, the people who are organized in unions and in consumer and other organizations, tend to be the older and more mature people. We think more about pensions. We think more about the additional income and security sometimes than we think about the young people coming into the labor force, and they have the least power to make their views known. So I think it is a very important problem that I think we have to work on. And I hope perhaps as we look at these tax measures, bearing this problem in mind, because it will be a perpetual problem for us, that ways can be found to alleviate it, and I would certainly very much would want to be alert to this, because I feel strongly about this based on my experience in Detroit.

Senator SCHMITT. The question is somewhat related to the concept of negative income tax and income maintenance programs of a wide variety of kinds. Do you have a comment on that?

Mr. BLUMENTHAL. I do not have a considered view of that particular device at this time. No doubt I will have to develop it.

I do believe that we do have an obligation to insure that no one in this country goes hungry and has shelter if there is a legitimate hardship. I do not include people in that group who are able and have an opportunity to work and choose not to do so. That is a different question. There are a variety of devices suggested to deal with legitimate needs. The idea of a negative income tax is one of them.

I would want to familiarize myself with it more before I give you a better answer as to which particular device I would favor.

Senator SCHMITT. The examination, I would hope, in the case of your office, will include the basic efficiency of the transfer of income, which is a goal we are trying to attain more and more, and whether you agree with it or not, determining if that efficiency is greater through the revenue process or through the actual, direct transfer through welfare programs of various types.

Finally, let me ask, have you considered some of the details of our intermediate term energy policy, such as it is, as it concerns coal. For instance, whether or not the development of a new coal industry in this country, including all aspects, exploration, production, utilization, are going to require some special protection, particularly against the threat of a precipitous drop in foreign energy costs, which still is considerably above the cost of actual production?

Mr. BLUMENTHAL. I only have a general view in regard to the energy question. It is essential that a comprehensive and integrated energy policy be developed by this country, and I know the President-elect intends to do so and Mr. Schlesinger will be particularly charged with carrying out that responsibility.

I further believe that the undue dependence on foreign sources of energy, and our growing dependence, is something that should give cause for concern, and that we have many different untapped sources of energy in this country which should be developed.

As with many of these matters, such development will require, in all probability, various kinds of Government action, different kinds intended to further that goal.

I certainly do believe that the vast resources of coal that are in this country are a very important source of energy that needs to be developed, and it may be that some protection is required. It may be that other forms of incentive that can be provided that will give business and mining companies an incentive to put the very substantial capital resources into that sector that are needed.

I would hope equally that other sources of energy, whether they are nuclear or solar, would also be furthered through the kinds of Government programs that could be considered in this regard.

I would hope, finally, that we do not, in the area of energy, deviate any more than necessary from the general policy of many administrations, Republican or Democratic, for an open trade policy with a minimum of restrictions, for only those restrictions necessary to protect employment and deal with particular hardship and special situations.

I firmly believe, based on my prior experience, Senator, that a general protectionist trade policy leads to similar policies by other countries and gets the world into very, very serious difficulty.

Senator SCHMITT. Thank you, sir. I have no further questions.

The CHAIRMAN. Mr. Gravel?

Senator GRAVEL. Mr. Blumenthal, I was impressed by your statement on wage and price controls. We both realize that the only area of our economy today that has, essentially, price controls is the energy economy. Can I take this to mean that you will vigorously press your views on the Carter administration to see a deregulation of our energy systems?

Mr. BLUMENTHAL. Senator, I am really not an expert on the economics of energy and I would not want—I hope you will not press me too hard to give you a yes or no answer on this.

My general philosophy is clear. I would love to see it applied to all sectors of the economy, but I would really request a little time to become more familiar with that before I give you a precise answer to that question.

Senator GRAVEL. I would be happy to take that situation. Let me just say that there are many people in the energy business—business people like yourself—who can recite at great length, ad nauseum, the horror stories that they have had with the Government. I underscore the fact that we have an energy problem in this country today because we have never faced up to our responsibilities politically. Our side or the executive.

Let me touch on another area.

As Secretary of the Treasury, you will head the national advisory council for international monetary and financial problems which coordinates U.S. participation in multilateral development banks.

What do you envision in the next 4 years as U.S. participation in these banks, the World Bank and other organizations? What would be our policy and ones for these institutions as it affects the underdeveloped world?

Mr. BLUMENTHAL. Among the most serious international economic policies that, again, have a great impact on our domestic economy, the question of the payments position of some of the developing countries and the growing disparity in growth rates and the national incomes that exist between these countries and many other countries of the world, that question, I think, is at the top of the list, and I would expect that there will be many different programs that will have to be explored, many initiatives taken, to deal with that problem, because I think it is a real threat to peace in the longer run.

I would hope that to the largest extent possible, whatever we do as a country with regard to economic assistance be handled through multilateral organizations where we can be one of a group of countries who work together and contribute to the solution of these problems.

I think that the time for a large national program or a bilateral program for economic aid is probably past except in certain exceptional circumstances. I expect our work in these international organizations to be very intense and very active. The principal problem that has to be addressed is twofold.

First, the question of what to do about these great imbalances in payments. We have a great surplus being accumulated by some of the OPEC countries. We have tremendous deficits that are being incurred by several of the developing countries—Brazil is an example, and many others, and how to deal with that problem is certainly very important.

The second question relates to this whole matter of commodities and the insistent demand of the developing countries for greater stability—

and, no doubt, from their point of view, a higher absolute level of prices over time for their commodities.

These are very difficult and complex questions. They have been around a long time. They now appear in a more inflamed and urgent context, and I think it is in the second area that through these multilateral organizations we are going to have to put our thinking caps on and try to find some new answers.

Senator GRAVEL. What do you envision our objectives are in respect to economic policy with Japan?

Mr. BLUMENTHAL. Our objectives in regard to our economic relations with Japan ought to be, in my view, to insure the highest level of trade and economic relationships bilaterally and multilaterally on a fair and equitable basis, insuring that American industry and American workers are not hurt by excessive concentration or excessive imports from Japan. We should recognize that Japan is one of our important allies, a major factor in the world economy, and that she has to export in order to earn the foreign exchange that is necessary for maintaining her own economy, and that we have a stake in a sound and stable Japanese economy and that our relationships should be directed toward that goal.

Senator GRAVEL. Moving to Europe I would like to include in the record, excerpts from a recent speech by the French foreign trade minister, Andre Rossi.

[The material referred to follows:]

EXCERPTS OF THE SPEECH BY FRENCH FOREIGN TRADE MINISTER ANDRE ROSSI BEFORE THE ECONOMIC AND SOCIAL COUNCIL, NOVEMBER 23, 1976

MULTILATERAL TRADE NEGOTIATIONS

(The introduction described France's importance as a world exporter and its interest in the negotiations.)

In a sense France is condemned to play an increasingly important role in international commerce. We must find counterparts to our energy and raw material imports, our need for using foreign labor and the assistance which France intends to provide to a certain number of developing countries.

France is a member of the European Economic Commmunity which today is the most important commercial power in the world. In these negotiations, which primarily concern the United States, Japan and the countries of the European Community, our country has a fundamental role to play in the preparation of Community positions and in overseeing the negotiations.

In the Council of Ministers, France participates in the definition of directives which permits the Commission, by applying Article 113 of the Rome Treaty, to conduct the negotiations on behalf of the Community.

My personal experience in the functioning of Community mechanisms and in Commmunity decision making leads me to believe that this way of organizing for negotiations undoubtedly gives to France a power and a mobility which is frequently less than that of our principal partners in the resolution of specific conflicts.

In a global negotiation, on the other hand, we can compensate this handicap by defining our objectives and our interests in a timely way. . . .

I will outline French objectives in the negotiation. Then I will indicate the most significant changes on the international scene since your council gave its last advice. Finally, I will describe French Government positions in the negotiations.

I. Objectives of the negotiation

There are three principal objectives in the MTN:

1. *To organize the framework of international economic relations.*—It is not, in fact, as the United States has sometimes advanced, a question of seeking a systematic liberalization of international trade. That view is completely contrary

to the interests of the majority of countries. Since the oil crisis, increased international competition has provided too many examples of the damage which fierce competition can do to certain sectors of the economy. Furthermore, the advisory report which you have just debated suggests that one can question the existence of a systematic link between the reduction of trade barriers and a correlated increase in national production and well-being.

The Tokyo Declaration itself states very precisely that these negotiations have as their objective "the improvement of the international framework for world trade." This is essential; liberalization of world trade is only acceptable if it is accompanied by rules which can assure:

Equality of conditions of access to different markets bearing in mind the sovereignty of national economic policy.

Regulation of the markets for certain products which under competitive conditions are subject to fluctuations which are as bad for producers as for consumers,

The adaptation or conversion of the sectors most affected by international competition,

International agreements regulating the trade of certain sensitive products of which the MFA constitutes one imperfect example.

But all of the results which might be obtained in organizing international trade will be in vain if parallel progress is not achieved in the monetary sphere. From this point of view the first two principles suggested by France and reaffirmed in the Paris Communique are fundamental conditions for a harmonious development of national trade:

The maintenance of fixed but adjustable parities,

The free convertability of all currencies.

A de facto link exists between trade and the monetary system. This link will not be lost sight of.

Finally, it is indispensable that the interests of all trading partners be taken into consideration and not only those of the industrialized countries. The Tokyo Declaration and Community texts concerning the MTN are important to the developing countries. The French Government has always considered essential the question of stabilizing the resources of these countries as well as the development of an industrial sector in them. Sooner or later it will be necessary that trade between developed and developing countries become more important than foreign aid. . . .

2. *To preserve Community personality.*—It is inconceivable that the Community should be weakened by the MTN. However, one had every reason to believe that in 1971, in proposing the negotiations, the United States sought to weaken the Community, aiming directly at:

The common external tariff,

The common argicultural policy,

The Community association policy.

In particular the CAP has again recently been the object of extremely violent attacks by the United States who tried to rally against the Community the large Latin American agricultural exporters.

These attacks are unacceptable. European agricultural policy is no different in its objectives and policies than those carried out by most countries which seek to:

Assure the public of sufficient agricultural resources on a regular basis,

Provide farmers with a standard of living comparable to that of other sectors of the population.

This policy does not translate into a reduction of commercial intercourse. As your report notes, the Community is in fact the largest importer and the second largest exporter of agricultural products in the world.

Maintenance of the CAP, a fundamental element of European economic unity, is one of the essential conditions for these negotiations.

But European identity also results from the common external tariff. Its maintenance at a significant level is one of the fundamental factors of the Community personality.

Moreover, an excessive reduction of the common external tariff would seriously diminish the advantages provided by the Community to certain developing countries and would lead to the questioning of our entire policy of commercial assistance to the economic development of these countries.

3. *To obtain equilibrium of results and not of concessions.*—If the principle of mutual advantage should be translated as the adoption of the same percentage of tariff reduction for all participants, certain countries including the European

Community would find themselves at the end of the negotiations with a level of protection having no longer any dissuasive character, while others would retain on some products significant tariff protection.

Such a situation would be fundamentally unfair. In tariffs these negotiations must result in comparable levels of effective protection for participating countries.

In the non-tariff area, a certain number of countries, in the front rank of which figures the United States, have adopted practices which are in formal disaccord with GATT regulations. It is particularly a question of the conditions in which these countries can apply countervailing duties to products which have received export subsidies. The United States uses the pretext of the protocol of provisional application to avoid applying established rules adopted by them in the anti-dumping code during the Kennedy Round.

It must be very firmly stated, and your report is very clear on this point, that the United States must yield like all other countries to international rules already negotiated. This is a precondition for all new negotiations on these questions and obviously would not be considered as a concession on their part.

This tendency to develop commercial practices in contradiction to international rules has developed in recent years. It accompanies an increase in protectionism throughout the world and constitutes one of the factors of the new context within which these negotiations will unfold.

II. International factors since 1973

(The speaker devotes several paragraphs to recent developments, particularly the economic recession and its effects on the developing countries. He continues with a discussion of protectionism as follows:)

The increasing difficulty of international competition leads certain countries to multiply their protectionist practices to preserve their national economies. In the front rank one must place the United States.

Far from reducing the differences between U.S. practices and international rules, the Trade Reform Act (sic) considerably reinforced them.

Not content finding itself at the beginning of the negotiations with one of the highest tariffs in the world, the United States provided itself in the Trade Act with an extremely protectionist legislative framework in total contradiction with GATT principles.

In particular:

Countervailing duty legislation must henceforth be applied in accordance with extremely strict procedures.

Legislation on the Safeguard clause is considerably strengthened. The President of the United States is obliged to apply restrictive measures if damage is established.

The provisions of Section 301, very dangerous by their generality, can be applied by the President to products receiving in their countries of origin discriminatory treatment judged unjustifiable or unreasonable.

To be less legalistic, the Japanese market is no less efficiently protected. . . .

And what about Europe? The Common Market appears to be one of the least protectionist groupings in the world;

Its Customs Tariff is the lowest in the world,

No single protectionist discriminatory measure has been adopted since 1971,

The Community has shown an extremely constructive attitude in all international negotiations.

The contrast between the extremely open attitude of the Community and the protectionism in the United States and Japan is certainly one of the important factors accounting for the steady growth of trade surpluses of these countries vis-a-vis the Community.

III. French positions

The first question which must be asked before considering position to be adopted in the different parts of the negotiation is the following:

In the international economic context of 1976 is it in the interest of France to continue these negotiations?

I will answer this question very clearly: We must continue these negotiations because we are already engaged but, above all, because it is in our interest to do so.

In September 1976, when we were still at one of the lowest points in the economic crisis, France reaffirmed at Rambouillet with the chiefs of state most directly concerned the principle of continuing these negotiations.

This is still in our interest for two reasons:

(1) International interdependence makes our economy particularly vulnerable to the ravishes of protectionism. Now, the major objective of these negotiations is not so much, as I mentioned earlier, the systematic liberalization of international trade. It is the establishment of an international framework which, by the disciplines it imposes, permits the avoidance of disastrous economic wars. By stopping the growth of protectionism which is developing in certain of our principal partners, these negotiations should permit maintenance and improvement of the framework of free international trade which has permitted rapid economic growth of these past twenty years.

(2) The decision-making mechanism in the Community makes us more apt to succeed in a negotiation together, well defined in terms of time, than to resolve to our advantage bilaterally a series of specific conflicts.

That is why, now that our positions are clearly defined, the negotiations must proceed rapidly and terminate in 1977 in an offensive and constructive spirit.

This is not the time to reform the GATT. It is too important a problem and too difficult to be handled in this time frame. The first thing to do is to have all contracting parties begin by applying the GATT. One cannot hide from the fact that these negotiations will be difficult. Our positions must therefore be very clear.

Agriculture.—Our position is based on three points:

(1) To establish a fundamental distinction between industry and agriculture. This has constituted one of the major objectives that we have given ourselves in the agriculture area.

At every opportunity the U.S. tries to go back on this principle. It will be necessary to remain particularly vigilant on this point until the end of the negotiations.

(2) Maintain complete autonomy of the common agricultural policy.

(3) Organize international markets for agricultural products by: commodity agreements, with price discipline and stockpiles for principal products such as cereals, sugar, etc.

A concerted market discipline for other products assure that operations on world markets on the part of exporting countries take place in an orderly way.

As the second largest exporter of agricultural products, France attaches particular importance to this area.

Industry.—In tariffs:

(1) Reduce high tariffs much more than others,

(2) Maintain at the frontiers of the Community a significant level of tariffs,

(3) Link any reduction of tariffs to the adoption by the United States of a simple system of valuation as close as possible to that adopted by the Brussels Convention,

(4) Preserve certain exceptions.

In the non-tariff field to attach priority to the effective application by other countries of accords which may result. In particular, subject any undertaking on our part on standards to an undertaking by the United States which effectively obliges American enterprises to conform to them.

Procedures for exceptions and adjustments.—

(1) Above all, have the U.S. themselves apply GATT rules.

(2) Consider the possibility of applying the safeguard clause selectively. This would permit more flexible protection, better adapted to each case, easier to apply, and one that would not harm countries not directly responsible for the commercial problem in question.

(3) Favor the establishment of collective surveillance so as to place commercial partners in positions of real equality. This should be considered in standards, in safeguard clauses, and in countervailing duties.

(4) Maintain sufficient parallelism between the establishment of efficient international monetary discipline and the application of the results of the MTN.

Conclusion

. . . as for me, as one in charge of the negotiations for France, I will shortly undertake a tour of European capitals to narrow our points of view by means of intensive conversations. In Brussels, at the Commission, I will assure myself that our way of seeing things has been fully understood.

I will also go to see the Americans and I will explain to them our position so that it will be with the full understanding of our interests that they contemplate the final phase. I will also have conversations with the other principal participants in the negotiations.

Senator GRAVEL. It makes clear that as far as the French are concerned, the trade negotiations are a heads-I-win, tails-you-lose proposition. That speech pompously and arrogantly states that Europeans are not under any circumstances going to remove their protection barriers, but that the Americans are great protectionists and must remove the few that we have. In short, they want everything their way.

What was your experience in negotiating at the Kennedy rounds?

Mr. BLUMENTHAL. Senator, I am a veteran of 4 years of these kinds of speeches and that type of negotiation. I believe that we should negotiate patiently and firmly and not at all be afraid to ask for a full quid pro quo for anything we do. That is certainly something that I tried to do. A major comment that I read in the foreign press when they heard about my nomination about this particular job was to recall that I was, in their view, too tough on them.

I am proud of that, because I have always believed that proper relationships do not involve giving more than you are getting, but to ask for as much as you are getting.

I am sure that most of our trading partners are going to ask for that goal, and I hope the American negotiators are going to insure that they are not going to succeed. I am not going to support any kind of outcome at the international trade negotiations which, in my judgment, would not give us an equal deal. Even though individual countries will try to get a little more, I think that we ought to be fully prepared and competent enough to insure that does not happen.

Senator GRAVEL. Thank you, I appreciate that answer.

What would be your definition of excess profits in the business community?

Mr. BLUMENTHAL. I think——

Senator GRAVEL. Let me put the question this way.

There is a lack of confidence—you know it as well as I do—a lack of confidence with the American public with respect to the business community, and more so centered in the energy area.

One of our problems is the perception that the American people have, that business rips them off in many respects.

What I would like to do is find out—for my own benefit and our edification—what your views are as to profit in the business enterprise, and is there a rip-off, or, is their perception correct?

Mr. BLUMENTHAL. I think that the perception is incorrect in my judgment. I know from surveys that I have seen, that when you ask the average person, "what percentage of profit do you think the typical American corporation makes?" you get numbers that are very far from reality, so I think that there is a misconception. The fact that a company like Bendix, for example, which now takes some pride—and justifiably so—of having become much more profitable than it used to be, at this point struggles to have a net income of slightly less than 4 percent, probably would be a surprise to the average person. That net profit rates that are much in excess of that, are an exception rather than a rule would be an equal surprise.

I really do not know what excess profits in a competitive free-market economy are, Senator. I think we need to insure that they are not monopoly profits, profits that are made as a result of restrictive practices or other market conditions which allow corporations to use their excess power as a result of this kind of restriction to rip off the public.

That is really the function of the antitrust laws and all of the regulations that we have in effect and they ought to be enforced clearly and fairly. In that kind of situation in a competitive, free-market environment, any profit that a company can make through more sales, better products, higher productivity, I welcome, because that profit is not lost. That profit is reinvested, creates new jobs, creates incentives and it is the reward for success, and the more of these kinds of successes we have, the more jobs that will be created and the better our total economy will be for it.

I do not know what excess profits are, other than profits garnered by means that are against the law.

Senator GRAVEL. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bentsen?

Senator BENTSEN. Thank you, Mr. Chairman.

Mr. Blumenthal, I am concerned about the concentration of investment in the stocks of a few major companies by pension funds. Pension funds are growing, and are going to continue to grow, substantially. We are seeing economic concentration. For example, one bank trust department administers well over $20 billion in assets. We have a change in the dollar volume of trading on the New York Stock Exchange. Several years ago individual investors were doing about 70 percent of the trading on the New York Stock Exchange. Today individuals are doing less than 30 percent and the financial institutions are doing the rest. The result is the nifty-fifty philosophy of 1975, where the pension managers only invest in major companies. We saw instances of pension advisors holding over 15 percent of the stock of a major company.

That is not allowed for insurance companies, and not allowed for mutual funds. Each has limitations about how much they can invest in the stock of a particular company, or the amount of the assets they could put into it.

There was a situation that developed with respect to IBM where you had a Federal judge come out with a decision that opened the door to an antitrust case against IBM. It was an Oklahoma judge, 3 years ago. Then all those financial institutions tried to get through the gate at the same time, selling IBM stock and it got awfully narrow and you saw a precipitous drop in the price of the stocks.

Then the judge redefined his decision a couple of days later, and the stock came back up.

I introduced legislation to remedy this and I would hope to have you testify before this committee on that. I would like to see those investment decisions spread as much as we reasonably can and would like to see limitations put on the concentration of assets in a company. This would be in the benefit of the pensioner, and in addition, cause some capital to be available to some of the medium-sized companies or small companies in this country. Do you have any thoughts on that?

Mr. BLUMENTHAL. I think the problem that you identify, Senator, is a very legitimate and very real one. I will certainly think about it seriously and be ready to testify before you. I think that it is well worth looking into. My one concern would be that we think carefully before we interfere in another way in the free-market mechanism and the freedom of trustees and others to make decisions that, in their judgment, are best for those for whom they are trustees so that we do not create a whole new set of rules and regulations that restrict the flow of capital to where it can be most productive.

Senator BENTSEN. I understand that, Mr. Blumenthal. These limitations have been put on insurance companies. They have been there for years. They have been on mutual funds.

You have a situation today where large pension managers can have a self-fulfilling prophecy on stock. We had some testimony where they were a substantial part of the dollar volume trading on that stock for months on end. That portfolio manager could make himself look awfully good just because he, in effect, was supporting that stock.

Those are some of the things that we have to look at.

Mr. BLUMENTHAL. Senator, I will be ready to testify on that. I will testify with some feeling, since my company was never one of the favored 50.

Senator BENTSEN. Nor mine.

I have one other concern I would like to address for the moment. In the 1976 tax bill, we changed one bit of terminology, the terminology where we talked about earned income in this country. Investment income was previously termed unearned income, as though it were something soiled, something in disfavor.

We were able to change that to personal service income and nonpersonal service income.

I am concerned that we do not destroy the upward mobility that we have always had. One of the things that has built this country is the idea that some poor fellow could bootstrap his way up if he is willing to gamble with a new business, yet we are putting some limitations on him to make it more difficult such as the limitation on deductible interest expenses.

I think incentives are important in this system of ours. The Charles Schultz series, where he was talking about putting incentives in and making the public objective the private objective, not trying to do it just by regulation, trying to anticipate every varied condition across the country, but to try to have the private sector have the incentive so they would fight for what are the national objectives.

I would like to hear your comment on that.

Mr. BLUMENTHAL. Senator, I will have a lot to learn about the details of the tax code and all of its problems. I am sure that I will get a quick and complete education as part of the tax reform work that will be undertaken beginning almost immediately.

This whole business of hopefully bringing about some reforms that bring down excessively high rates, that eliminate double taxation, that create incentives such that the tax system works for us and works for the average person rather than against the average person and for the economy while raising the necessary revenues for the Government, that clearly is going to have to be the goal as I would see it of any kind of reform, and I agree with Mr. Schultz in making that point.

I have never—and I really speak as still a private citizen—never fully understood the philosophical basis for the distinction between earned and unearned income. I never fully understood why I, not having inherited any money, having the opportunity to make some savings and having invested these savings, why I am being taxed more heavily on the return of these savings which, after all, are being put back in the economy, than I am taxed on my so-called earned income, my salary, my bonuses, my fees, and the other forms of direct income that I have had.

I have always thought that I should be rewarded for having contributed enough to be paid enough salary, and having saved enough to put that back into work in the economy.

I, at least, find philosophical notion appealing for all Americans, that when they save their money they get taxed no more heavily than they do for any other kind of income.

I am sure that it raises all kinds of difficult problems. There are certain types of unearned income that perhaps are of a different nature. All of that is something that needs to be considered and will be considered as a part of the tax reform work that will be done, and I hope that what will come out of it will make the kind of sense that we all have in mind.

Senator BENTSEN. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Thank you, Mr. Chairman.

Mr. Blumenthal, when we finished our last colloquy that ended because of the time limitation, I pointed out that for the fiscal years 1975–76 that we had a deficit of $109 billion and as a projected deficit for the upcoming year even before adopting the program that might be advocated by the new administration of more than $50 billion, and you very correctly pointed out—at that point, the colloquy ended because of time—that you inherited that deficit, and most certainly you did.

But it brings to mind 8 years ago a very able, extremely able banker from the city of Chicago became Secretary of the Treasury, Mr. David Kennedy. He pointed out that the new administration was inheriting a tremendous deficit from the Johnson administration, $13 billion. I point out today that a deficit has not been that low since.

Now, what I am hoping is that the new administration does not take the deficits of the Nixon-Ford years and pyramid additional deficits on top of that. But it appears to me that we are beginning, at least, to go in that direction.

May I ask, what will be the total national debt at the end of the current fiscal year?

Mr. BLUMENTHAL. I really do not have that figure.

Senator BYRD. The answer is $700 billion.

Mr. BLUMENTHAL. No doubt you know the figure better than I. I do not have the figure clearly in mind, sir.

Senator BYRD. What I am leading up to, before we advocate additional deficits, is it not important to realize what the deficits are now, what the debt is now, and to realize some additional figures that I think are tremendously significant?

I will not ask you the question. I am not sure that you have thought exactly along this line. I would hope that you would think along this line.

For the 7-year period, Mr. Secretary, 1971, fiscal 1971 through fiscal 1977, 42 percent of the total national debt would have been incurred, 42 percent of the debt would have taken place during that 7-year period. To me, it is appalling, number one, that it be such a high percentage and such a tremendous debt. Number two, it is appalling that it would happen under a Republican occupancy of the White House.

I must say that I am not much of a partisan. Of the 96 counties that we have in Virginia, if you leave out 4, of the other 92, in the last election, Byrd and Carter carried half of them and Byrd and Ford carried the other half. So I am not much of a partisan, but I think that it is appalling, and I am somewhat disturbed that the new administration is beginning, even before it takes office to go in a direction to which it will accelerate these deficits.

You have been very eloquent this morning in your statement as to the need for a balanced budget and a need to manage the Government where we do not have unbalanced budgets, but it seems to me what we are advocating—not we, I am advocating—what you appear to be advocating will lead to more and more deficits, unless you assume that the way to get a balanced budget is to spend more money.

Mr. BLUMENTHAL. May I make a comment, Senator?

In the first place, to make matters worse, I am afraid that the $50 billion figure that you mention will be low.

Senator BYRD. It will be low, under your proposal.

Mr. BLUMENTHAL. Low, even without the incoming administration doing anything.

Senator BYRD. I agree with that.

Mr. BLUMENTHAL. The figure I have seen is $60 billion, given the shortfall in revenue and the lower level of economic activity in the economy.

When I said that we were inheriting a deficit more likely in the area of $60 billion, so to have the figures right as I remember them, Senator, anything that is spent by the incoming administration is going to be on top of $60 billion and not $50 billion. It is a large figure.

Senator BYRD. Thus, the country is looking at a deficit now of somewhere between $70 and $75 billion this fiscal year?

Mr. BLUMENTHAL. That is my understanding.

Senator BYRD. I rather suspect that that is why there is so much speculation in the newspapers and on the part of the business community that inflation is being stimulated and will continue to increase.

Mr. BLUMENTHAL. I was impressed by the fact that in the consultations in which I participated in the short period since I have come here to Washington to get ready for my job in the last few weeks, with a wide range of people including representatives from the business community and a large cross section, including bankers, including a wide range of economists with different views, including some who were prominently associated with prominent Republican administrations, the feeling that something had to be done was virtually unanimous—I say virtually, because we always find somebody who disagrees, but virtually unanimous.

I do want to reassure you that I am impressed by the deep conviction that Governor Carter has, and I share, that we must bring that huge number down quickly, and that the goal of achieving a balanced budget no later than 1980 is one to which he attaches considerable importance, and I share that view.

It is our hope and expectation as the economy accelerates in its growth that we will be able to achieve the goal, that I am sure you will welcome, to bring us to a balanced budget or, at any rate, very close to it.

Senator BYRD. I spent an hour with Governor Carter last month and I came away most impressed with him, and impressed with what I consider his desire to achieve a balanced budget. As I say, again, what is being advocated is not aiding in that direction.

You mentioned the experts feel that something has to be done and that we have to go to more deficits to improve the economy. Well, I lost confidence in the experts many years ago. For example, 10 years ago and 9 years ago and 11 years ago all the experts in Washington said that the way to handle Vietnam was to have a limited war, to have a limited war in Vietnam. The smartest man in Washington, according to anybody you would run into in the corridors of the Capitol, or the Senate Office Building, wherever you might be, was Robert S. McNamara. Whatever he said, he was the expert. All of the other people echoed what he said. Today we all know that not everybody is saying that he is the smartest man in Washington.

So I do not have much confidence in the experts. What I am saying is, as a matter of commonsense, it is not likely that we can continue to pile up these huge deficits, not just deficits, but accelerated deficits, one on top of the other, and increasing them, and then say we are going to get to a balanced budget.

Let me ask you another question.

Do you feel that we should take off the ceiling on the amount of earnings that social security recipients can receive?

Mr. BLUMENTHAL. I am not really prepared to give you a considered response to that, Senator. I would be glad to look at that and give you my answer the next time I appear before this committee.

I must confess that I do not know what the present ceiling is.

Senator BYRD. $3,000.

The Congress has written a ceiling of $300 million on the amount of loans that the Export-Import Bank might make to the Soviet Union. Would you support a continuation of that ceiling?

Mr. BLUMENTHAL. I believe that economic relations with the Soviet Union, including trade with the Soviet Union, has to be considered in the context of our overall relationship. I do not believe that we can look upon trade, and the financing of trade with the Communist countries or the Soviet Union, as something apart from overall relationships and I would think that, whether it is a question of continuation of that ceiling, the raising or lowering of it ought to be a decision that is made in the context of an overall relationship that develops through negotiation.

Senator BYRD. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Blumenthal, we have a new congressional budget process that has not given us a balanced budget. I believe you know, if you did not know before, that Senator Byrd, like his father, is the most consistent advocate of a balanced budget that this Nation has ever had.

Mr. BLUMENTHAL. I know that, Senator.

The CHAIRMAN. Sometimes in that respect, he reminds me of a situation that occurred in Louisiana when we had a severe flood. Some people looked out the next morning from a house with living quarters on the second floor, to see a hat on the top of the flood water going around in a square. All they could see was a hat moving on the water in a square.

Someone asked, "Why is that hat moving around in a square out there," and his son answered, "That's because Grandpa said he was going to cut the lawn, come hell or high water."

Senator Byrd's predecessor on this committee, the other Harry Byrd, used to tell me that he was the last of the New Dealers. When Franklin Roosevelt started out, he promised to balance the budget. Harry Byrd at that time was Governor of Virginia and he supported him enthusiastically on that platform. My father supported him at the same time, and he read the platform differently. One man thought the platform read one way, another thought it read another way.

If we have now decided that we are really going to balance this budget, I suggest you put Harry in charge of it. He can definitely show you how to do it, if we do decide.

I am sure you know President Carter wants to get that job done within 4 years. I hope that we can bring it about.

I would hope that I could reach an understanding with you in the beginning about trade figures. The Department of Commerce in particular likes to publish trade figures on a basis that leaves out the freight, leaves out the insurance, and adds to the total foreign aid. For example, if they had their way about it, we could report that we had a surplus in trade by just giving enough stuff away—the giveaway would be added to the trade figure to say that you had a trade surplus, even though you are not going to be paid for those things you give away.

We by law have required our negotiators in Geneva to negotiate on a CIF basis, to take into account the cost of insurance and freight. I wish we could have an understanding with you that when you appear before our committee in the future, or when your Under Secretaries or Assistant Secretaries are speaking for you, that if they want to put those trade figures in that context on a FAS or FOB basis, they should also have them without the soft currency sales and with the freight and with the insurance, just to show, what it would be on a CIF basis. For example, the way I would read them right now, the exports are listed at $104.5 billion, January through November 1976. If you leave out the foreign aid aspects of it, it would be about $102.5 billion. The imports on a CIF basis are about $117.6 billion. That would leave us with a real trade deficit of about $15 billion.

On a CIF basis, if you count in the exports the foreign aid or soft currency sales, it would be a $13.1 billion deficit. Energy imports are $28.9 billion. Those imports alone are about twice as large as our trade deficit.

I would hope that under your leadership with the cooperation of others in the executive branch, you will try to bring us a program that will progressively reduce our energy imports.

Do you agree with me that we are going to have to find some way to produce a great deal more energy here if we are going to achieve our Nation's goals?

Mr. BLUMENTHAL. I agree that that would be highly desirable.

The CHAIRMAN. Would you undertake to see to it that we receive the information before this committee on the basis that I ask it?

If you want to go ahead and put it on the "good-news" basis where they claim to have a surplus, even though we know that they are losing money, that is all right with me, provided that in the same statement and in print equally as large in a footnote, you show what the bad news is, so that we can take our choice between which set of figures appeal to us the most.

Thank you very much for your statement. I have no further questions.

Senator BYRD. Mr. Chairman?

The CHAIRMAN. We have not finished with Mr. Blumenthal. I am going to call upon Senator Hansen.

Senator HANSEN. I yield to Senator Byrd.

Senator BYRD. I just did not want you to close the meeting.

Senator HANSEN. After having said that, let me observe, on behalf of a very small, shrinking and threatened minority, that no money was spent, or has been spent during the last 8 years, that was not first appropriated by the Congress of the United States. The Appropriations Committee is on the Hill, not at 1600 Pennsylvania Avenue.

I do not state this because I disagree at all with by good friend from Virginia. I do not disagree with him; I agree with him completely.

I make the point—and I join with him in deploring the deficits that we have—that I am aware of the fact that we are the people who spend the money. You know, too, that one of the earlier Presidents tried to do something about that. He impounded a little bit of the money.

Well, he got taken into court, because the Congress said, "What the hell do you mean you are not spending all that we have given you?" Congress wrote the Budget Act, they drafted some legislation in there so that this could not happen again. We are going to be sure that those people who reside down at 1600 Pennsylvania Avenue spend all the dough we appropriate for them.

I join with my colleague, the chairman of the committee, Senator Long, in paying tribute to Harry Byrd for the fine job that he has done in trying to hold the line.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Schmitt?

Senator SCHMITT. Two final questions, and I hope they will be short, because I know the hour is late.

One goes to the heart of the problem that I think the Senator from Virginia was getting to, and that is that there is an excess of plant capacity in this country in many areas, particularly in the industries that you are associated with.

One of the encouraging economic signs has been an increase in the investment capital for new plant and new equipment.

Do you feel that this increased deficit, this $10 to $15 billion that may be added as a result of the Carter administrations economic proposals, will, in fact, impede the continuation of that investment?

Mr. BLUMENTHAL. Senator, I believe that the growth in investment and the surveys of investment intention indicate that investment has been disappointing, it has been too slow. This is one of the reasons the economy has grown, but a real growth of only 4.5 percent, or slightly less, rather than at the higher figure that was originally expected and anticipated.

I know that even with regard to my own company, because we are in the capital goods business in part, and we had expected a much more rapid order intake in the machine tool area, for example. It is the goal of this package that the President-elect is suggesting to create more consumer demand; to provide some, although limited, tax relief for business; to make clear that some of the tax simplification that is being proposed is really permanent; until we begin to see a permanent trend that business can count on, so that all of this will lead to the acceleration of investment decision and therefore the creation of more jobs at a higher level of activity.

Yes; I believe that it is intended to do that and will do that.

Senator SCHMITT. The impact of capital investment in heavy goods and machine tools and the like is quite a bit delayed in comparison with the impact of at least major portions of the Carter proposals, as I understand them. As a matter of fact, we may not even have been given the time to see the effects of some investments made last year in the creation of jobs and accelerating economic activity. Isn't that true?

Mr. BLUMENTHAL. The heavy equipment and machine tool area is a lagging industry in that regard. The indicators are lagging. You begin to see it first by the rate of order intake, then the leadtime before you ship is quite long, a year and a half, 2 years. There has been an increase in order intake as compared to a year ago, but it has been slow and sluggish. It has begun to build, and the first shipments out of that growing backlog would presumably lead to rising shipments later in calendar 1977 and on into 1978.

The stimulus that would be as a result of the President's program, if enacted by the Congress, would hopefully lead to further order increases which would begin to bite in 1978, the second part of 1978, perhaps on to 1979.

Although there is a lag, I believe that there is nothing that makes investors in companies invest more than the ring of the cash register and the feeling that the ring of the cash register is going to continue.

Senator SCHMITT. Will not the deficit that Senator Byrd so ably pointed out tend to reduce the capital supply that is available for these kinds of orders, even though the ring of the cash register may be there in the future?

Mr. BLUMENTHAL. I do not believe that the amounts that we are talking about here, with the kind of slack in the economy, with the considerable capital resources presently available, with the relatively low level of loan demand that the banks have, that there is any serious risk at all for this period that we are talking about that there will be a crowding out of the private investor because of the additional amounts of money that are going to be spent by the Government.

Senator SCHMITT. The loan demand reduction is partly related to housing?

Mr. BLUMENTHAL. Housing, as a matter of fact, Senator, has been doing relatively well. Housing starts are at an annual rate of 1.7 million. The two brightest spots in the economy are housing and automobiles.

So I think that loan demand being low, to some extent, is due to the fact that companies have been cleaning up their balance sheet the last time around, when interest rates were very high, and they have been holding back on investment decisions. In our company, we looked at them very carefully, because we really were not sure about them.

I hope my successors will have a greater sense of security in the months to come.

Senator SCHMITT. One final question. I think that the answer could well be delayed, or submitted for the record, or at some future time when the subject comes up.

Your experience in international negotiations in trade and other things is well recognized. In my travels throughout the developing world in recent years, it has impressed me, first of all, that American companies should not accumulate equity in their investments in these areas, but that there is seemingly a great potential for contract services of various kinds over a fixed time frame with what one may call educational causes, that they are ready to take over the particular service that you are contracted for.

As you approach your new job, I hope you will examine just how extensive this kind of activity can be. I personally feel that it can be quite extensive and may, in fact, eventually form the cornerstone of a new foreign policy where the nonmilitary strengths of this country are being emphasized, rather than the military strengths, and maybe offer some hope for future generations.

I am sure that there are many complexities. What is the funding source, the World Bank, other sources like that may well be as important as anything we may contribute, more important. It is one way in which I think that the strengths of the American institutions, both private and industrial, can be applied to a very important problem in the world: That is, bringing the developing countries into the 20th century. If they are not part of the 20th century, we are going to continue to have problems. There is no answer necessarily required. You may comment, if you wish. But I hope that you will consider it.

Mr. BLUMENTHAL. I certainly will deal with these questions, Senator, and respond to them. There are some important opportunities in this area.

Senator SCHMITT. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Byrd?

Senator BYRD. Just a couple of brief questions.

First, I want to concur in what the Senator from Wyoming, Mr. Hansen, had to say. The Congress is, was and is, a major partner and the deficits of the past few years would even be larger if that major partner had its way completely.

Mr. Blumenthal, Treasury is responsible for financing and managing the national debt. It is understandable, therefore, that Treasury should be more concerned about the inflationary impact of Federal spending and regulation than other departments.

What is your outlook on the inflation rate over the next several years?

Mr. BLUMENTHAL. Senator, I hesitate to venture too many predictions going out several years; predictions of that kind are hazardous and by their very nature, very uncertain.

I would predict, however, that over the next year or two, with the kind of care and caution that I expect the incoming administration to exercise, certainly with the concerns that the Treasury will have about this matter, that as we move towards a higher level of economic activity, we will do so without any increase, and indeed, with a declining rate of inflation.

There may be individual months when that differs, and that trend does not occur. As a general trend, however, I would expect the rate of inflation not to increase, but to decrease.

Senator BYRD. Interest rates were mentioned earlier in the day. The Federal Reserve Board can have an effect on short-term interest rates. It can to use a word, manipulate, to hold down short-term interest rates.

Am I not correct that there is not much it can do, as a practical matter, to hold down the long-term interest rates?

Mr. BLUMENTHAL. Obviously, there is an interest-rate structure and there is a relationship between short term and long term rates, but I agree that the Federal Reserve has more impact on short-term rates as opposed to long-term rates. In an indirect way, I think it can affect long-term rates.

Of course, through a monetary policy, together with fiscal and economic policy, it does have an important impact on expectations, which again translate themselves into the cost of long-term money.

Senator BYRD. Should steps be taken to utilize the tax code as an instrument to foster higher rates of reinvestment? If so, how?

Mr. BLUMENTHAL. I believe that in our review of the system of taxation, and in our efforts to reform and simplify, that we should very much bear in mind the need for a faster and higher rate of capital formation in this country. If there are ways that can be done through the tax code, I would favor it.

Senator BYRD. How do you feel about depreciation rates? Canada has gone to a very high depreciation. I believe that it runs 50 percent the first year. It writes off investment in 2 years.

Does that appear practical to you?

Mr. BLUMENTHAL. I would have some question whether we could go to a 50 percent rate the first year. I think the question of depreciation rates ought to be looked at as a part of the overall tax review, yes, sir.

Senator BYRD. Thank you, Mr. Secretary.

Mr. Chairman, I may have some questions I would like to submit for the record.

The CHAIRMAN. I would propose, Mr. Secretary, that all members have the privilege of submitting additional questions that you could answer in writing for our benefit.

I do not feel that we should close this record without exploring one other matter. You have come here, Mr. Secretary, at a very great financial sacrifice. I do not believe a man would do that unless he felt that he had a chance to do something for his country for which he would be remembered.

Your life is a modern Horatio Alger story, an inspiration to all those who come to this country of what can be done with their lives.

I have detected, in visiting with you, that you have the belief that American capitalism should be a very good deal for others who lack the fantastic intellectual talents that were bestowed upon you, and I believe that this record should reflect a little bit of your feeling along that line.

I know that the President, in choosing you, was in the hope that you would appeal to the business community as one who understands their problems. But I believe we are also fortunate in that you reflect a philosophy that I hope will grow in the business community. I think you should give us a little of your views about what your objectives are and what your goal is for this country, insofar as you can contribute to it.

Mr. BLUMENTHAL. Senator, I was privileged to come into this country as an immigrant at the age of 21 and I came here as a refugee from persecution and as someone who had the opportunity to see at firsthand what injustice and human suffering can mean to people, and what the lack of opportunity and discrimination of people, innocent people, can mean.

I am proud of the fact that I was able to come to this country and that I was allowed to develop my talents, get an education—I had to work for it, but I got it—and to use it usefully. And in the various things that I have done essentially in this country, people have not asked me where I came from and who my father was, but have looked at who I was and what I could do and have rewarded me accordingly.

I therefore, certainly consider it a privilege to have the opportunity to serve. I feel I have been amply rewarded in the past for my work and, although my income will be substantially less, it really does not worry me that much. I appreciate the opportunity to serve.

My past background and experience, and I think the kinds of things that I was pleased to do within the private sector and in particular with Bendix over the last few years are, I think, evidence of the fact that I feel that the kind of opportunity that I have had in this country should be bestowed on all citizens and all citizens of this country are entitled to have it. And wherever we find injustices, discrimination, or where we find the cards stacked against a particular group of citizens from an economic or social viewpoint, we have a responsibility to see that that situation is corrected.

I fully intend, in discharging my duties as Secretary of the Treasury, to work toward that end, and having worked at all levels of this country, all the way from a $40-a-week billing clerk and an elevator operator on up to the chief executive of a very large corporation, I think I understand what the aspirations of people are and what the elements of discriminatioin are that remain in this country. And I can assure you, in providing my advice to the President with regard to the formulation of policies that he must decide upon and in which I have a role to play, that my life's experience will always be a major part of my motivation and of my thinking, and of my advice.

The CHAIRMAN. I, for one, have been concerned that so much of our corporate stock is held by so few and so many have so little of it, and that the opportunities of this land have altogether too often been rather limited.

What is your attitude toward that type of concept?

What attitude have you evolved toward stock ownership in your company?

Mr. BLUMENTHAL. I have strongly believed in the most broadly based participation in the free enterprise system and the most participation that we can achieve. In the Bendix Corp., we instituted the salaried employees savings and stock ownership plan. Under that program, we made it possible for people to put aside a certain portion of their earnings, and we match that to the extent of 50 percent of what they put aside, up to a certain level.

And that money was invested. People could choose whether to invest it in Government bonds or in stock of the company.

Since our people had confidence in Bendix, some 90-some percent, I believe, chose to invest it in Bendix stock, such that today, if my memory serves me right, something like 17 percent of the stock of the Bendix Corp. is owned by the employees of the Bendix Corp. The largest single shareholder of the Bendix Corp. is the salaried employees savings and stock ownership plan.

You cannot imagine what that has done to morale and to the interest of my colleagues, from the lowest salaried employee on up. They watch the stock market—they watch it too much, I think—and you go to many offices and you actually see a sign at the door with today's noon price, because they all have an interest in it.

I have gone around and instituted employee meetings where I discuss with employees what we are doing and why we are doing it; and what we expect from them; why we have certain problems; certain things that we cannot do that they want us to do; the fact that they are themselves shareholders has been a very imporant factor in the success of my company. I have no doubt about it. It is very hard to prove: I just know that that is the case.

I would strongly support similar measures. We are not unique. Other companies are doing the same thing. The expansion of that notion on the widest possible basis, I think, is a very excellent way to help provide a sense of participation, a stake in the system that we have, and better productivity and contributions from all concerned.

The CHAIRMAN. I believe we are going to have to have an improvement on this system of ours or see it go down the drain, and I believe that the answer is improvement. I think that we can either be the hope of the whole world, or we can be the disappointment of the whole wide world. I believe from your service, Mr. Secretary, that you want to move us in the right direction. I will be very proud to vote for your confirmation.

Mr. BLUMENTHAL. Thank you.

The CHAIRMAN. Are there any further questions, gentlemen?

Thank you very much, Mr. Secretary.

We do have another witness to testify here, Mr. Ronald Kokinda. I will call him as the next witness.

STATEMENT OF RONALD S. KOKINDA, NATIONAL COMMITTEE OF THE U.S. LABOR PARTY

Mr. KOKINDA. Thank you, Mr. Chairman, Senators. My name is Ronald Kokinda and I am testifying here today on behalf of the U.S. Labor Party. I want to urge that the Senate not confirm the nomination of W. Michael Blumenthal as Secretary of the Treasury.

The incoming Secretary of the Treasury has the awesome responsibility of reasserting the role of the United States as a leading industrialized country, committed to policies which foster capital-intensive industrial and agricultural growth throughout the world. Mr. Blumenthal, however, together with other members of the Trilateral Commission on which he sits, has through his career, demonstrated his commitment to a policy broadly defined as zero growth. If this policy prevails, it will mean further rapid disintegration of the industrial and agricultural potential of not only the United States but of the entire world economy.

To competently judge whether Mr. Blumenthal is suited to hold the position of Treasury Secretary, we must first look closely at what the requirements of that office are at this time. The world economy has not recovered from the new depression which it visibly entered in late 1974. The illusory recovery which began in the spring of 1974 was premised entirely on unsustainable Government deficit spending and consumer credit expansion in the United States. The slight effects of the 1975 tax cut and related measures on the business activity of the United States and its trading partners had dwindled by February of 1976, as could have been expected.

The 1975 tax cut was doomed to failure—as is the new tax cut proposal made by President-elect Carter and his economic advisers including Mr. Blumenthal—because it ignored the real cause of the depression—an obsolete international monetary system which strangles world production. Hundreds of billions of dollars are diverted annually from productive purposes to the payment of debt service on some $3 to $5 trillion of outstanding dollar liabilities.

The policies of budget balancing and austerity which have been enforced with a vengeance over the last 2 years by the New York commercial banks and their allies at the investment banks to protect their paper holdings hasten the demise of the productive economy. The steady deterioration of the condition of our cities, the economies of the developing sector, and the work force and plant and equipment of the industrialized countries attests to the criminal incompetence of austerity.

U.S. economic policy must deal with the real source of the world economic crisis. To do so, our Nation need merely accept the proposals already put forward by European and developing sector nations, proposals enunciated at the Colombo, Sri Lanka, meeting of the nonalined countries last August and since then repeated in other international forums. These proposals advocate the sweeping aside of the current bankrupt international monetary system by the declaration of debt moratoriums and the establishment of a new financial and economic system whose primary goal would be the fostering of world industrial and agricultural development.

The declaration of debt moratoriums and the establishment of new credit arrangements would immediately reverse the present stagnation by creating an unprecedented demand for U.S. industrial and agricultural exports as well as technological expertise.

Central to the new system would be the creation of an international development bank to fund major agricultural and urban development projects at low interest rates for the developing sector. These programs would be carried out through government-to-government treaties among the developing countries, the OECD nations, and the Comecon nations. An essential element of such an economic development program would have to be an international crash program for the development of thermonuclear fusion power, as the rate of expansion of the world economy under the International Development Bank will rapidly exhaust all presently available energy supplies.

We have every reason to believe that Mr. Blumenthal would implement economic policies that are diametrically opposed to what is now required for the good of the country. Mr. Blumenthal, throughout his career as an economist and business leader, has acted on behalf of those narrow interests of the New York banks, especially those connected with the Rockefeller family and against the actual industrial interests of this Nation. This charge is borne out, first of all, by Mr. Blumenthal's participation in a long list of Rockefeller-dominated Atlanticist institutions: the Rockefeller Foundation, the Trilateral Commission, on which Mr. Carter and Mr. Mondale also sit, the New York Council on Foreign Relations, the Atlanta Council, the Atlantic Institute, and the now-disbanded Initiatives Committee for National Economic Planning. Mr. Blumenthal, of course, shares the dubious distinction of belonging to the Trilateral Commission.

The Rockefeller Foundation, of which Mr. Blumenthal is a trustee, has been chiefly responsible for spreading the myth that the world economy has reached the limits to growth and that the populations of the world must be sharply reduced. Studies funded by the Rockefeller Foundation advocate the reduction of the Third World's imports of capital goods and the substitution of labor-intensive production modes.

The Trilateral Commission, chaired by David Rockefeller, is presently engaged in an effort to maintain the financial and political power of the Lower Manhattan forces by forcing a two-sided program of reflation and austerity on the world. Such a policy must necessarily be wildly inflationary and destructive of real economic growth as it involves unending paper creation on the one hand and unending depletion of productive potential on the other.

Throughout Mr. Blumenthal's career his specialty has been the field of "labor relations." Mr. Blumenthal has worked on a number of research projects in the field of labor relations such as a report on "codetermination in the German steel industry." As an executive and finally chairman of Bendix Corp., labor relations, which is a completely bogus field funded by various Rockefeller outlets, has thrived since the 1957 recession stagnation of the U.S. economy.

At the point at which the cancerous growth of debt obligations began strangely real-income growth—it was left to labor relations experts like Mr. Blumenthal to arrange labor contracts that gouged profits out of working people's income. This policy is as much antibusiness as it is antilabor, since the destruction of labor power undermines the long-range growth potential of the economy.

The logical conclusion of the labor relations experts outlook is no less than the commitment to full-fledged Fascist economics—the imposing of levels of wage austerity that make it impossible for labor to reproduce itself. This goal was actually enunciated by the Initiatives Committee National Economic Planning to which Mr. Blumenthal belonged with Wassily Leontief, Leonard Woodcock, and others. In early 1975, ICNEP called for the creation of an office of national economic planning whose purpose would be to reorient the economy away from a commitment to capital-intensive development.

At a public forum in the spring of 1975, ICNEP boldly distributed the reprint of an article called "The Coming Corporations" from the March 1975 issue of Challenge magazine. The article states "corporatism is fascism with a human face." The article describes the four goals of corporatism as: (1) order achieved "through imposing intensive State control in all areas of major economic activity"; (2) markets and some attempt to control strikes, ultimately perhaps through coercion"; (3) nationalism or "the elevation of the 'general unity, based on "corporatist intervention and State regulation of labor welfare' to complete priority over self-interest or sectional advantage"; (4) finally, success, defined as giving conscious direction of the economy by establishing priorities and targets and by restricting work done toward alternative objectives."

"Let us not mince words," says the article, "corporatism is fascism with a human face."

Before I finish my statement, I would like to refer to a special report to the U.S. population that was published by the Labor Party. It is called "Carter and the Party of International Terrorism." That quotes a little bit more extensively from the Challenge article, whose editor, publisher, and editor of Challenge, was Sharp who sat on ICNEP with Mr. Blumenthal and a section of the article bluntly reads:

> The four goals of corporatism have become increasingly explicit during the coming economic crisis. Order, unity, nationalism, and success. These, then are the four aims. Let us not mince words. Corporatism is fascism with a human face. The economic strategy that the Italian Fascists, the Phalange in Spain, Portugal and the inter-war crisis for workers corporatism has a certain short-term appeal. Corporatism, government should certainly guarantee full employment. The parts of the guarantee would, of course, be wage control and restraints on the freedom of industrial action.

The questions I urge the committee to ask the nominee before you close your deliberations:

Does Mr. Blumenthal, as nominee for Treasury Secretary, still adhere to the ideas publicly endorsed by ICNEP, which describes itself in favor of the finance policies of Hitler's Finance Minister Hjalmar Schacht—ideas at variance with the traditions of our industrial democracy?

Does Mr. Blumenthal believe that his longstanding ties with the Rockefeller family-dominated institutions would make it difficult for him to equitably pursue the economic interests of this Nation as Secretary of the Treasury?

The CHAIRMAN. Thank you.

That concludes this hearing.

Are there any questions?

Senator HANSEN. No questions, Mr. Chairman.

The CHAIRMAN. The committee will recess until 10 o'clock tomorrow.

[Thereupon, at 1:10 p.m. the committee recessed, to reconvene Thursday, January 13, 1977, at 10 a.m.]

[By direction of the chairman, the following communications were made a part of the printed record:]

[Mailgram]

ANN ARBOR, MICH., *January 8, 1977.*

Senator RUSSELL LONG, *Chairman,*
Senate Committee on Finance, Senate Office Building,
Washington, D.C.:

Strongly endorse the nomination of Michael Blumenthal as Secretary of the Treasury. I have known him personally as family friend, business colleague, and community leader. He is a person of unquestioned integrity and outstanding ability and leadership. He has a well balanced view on the responsibilities of both the private and public sectors in the development of national policies. I have full confidence in his pragmatic and socially conscious approach. It is my judgment that he will carry out his duties as a member of the cabinet with competence and capability.

WILBUR J. COHEN,
Dean, School of Education, University of Michigan.

WOMEN EMPLOYED,
Chicago, Ill.

STATEMENT BY WOMEN EMPLOYED REGARDING CONFIRMATION OF W. MICHAEL BLUMENTAL AS SECRETARY OF TREASURY, JANUARY 12, 1977

Women Employed is an organization of 1,000 working women in Chicago's downtown area which has been active in dealing with sex discrimination in employment for the past four years. We are pleased with the selection of W. Michael Blumenthal for Secretary of Treasury and are hopeful that his appointment and confirmation will lead the Treasury Department in new directions. Specifically, we are concerned with Treasury's responsibility for contract compliance mandated by Executive Order 11246. Over the years, Treasury, has been severely criticized for its lack of enforcement activity in this area. Given Mr. Blumenthal's past record at Bendix Corporation, we are optimistic that he will devote his attention to improving Treasury's performance in promoting equal employment opportunity in the banking industry. We look forward to working with him in order to achieve such a goal.

Questions Submitted by Senators With the Response of Mr. Blumenthal

QUESTIONS OF SENATOR HARRY F. BYRD, JR.

Gold Reserves

Question. From time to time, some citizens have voiced concern about reports that the U.S. Treasury does not actually have the gold reserves it claims to have. Would an audit of the reserves, conducted by a non-government firm of good reputation, be useful?

Answer. I do not believe an audit of gold reserves by a non-government firm would be useful. In February of 1975 the Government Accounting Office submitted its study on the "Accountability and Fiscal Controls of Gold Bullion Reserves" which thoroughly covered every aspect of our six gold depositories. Additionally, in June of 1975, Secretary Simon initiated a continuing audit of U.S. gold reserves which is being carried out by the Treasury's Government Financial Operations Office in cooperation with the Bureau of the Mint. This ongoing audit is thoroughly reviewing each gold depository.

At the present time the Treasury can state without reservation that allegations concerning the unlawful removal of gold from any U.S. Government depository are unfounded. The above mentioned recent audits and published statistics show that such changes are baseless. All of the gold ever stored in the Fort Knox depository remains in its vaults or is accounted for either in changes in the volume of gold stored in other depositories or in changes in the total United States gold stock as publicly reported.

International Finance

Question. Mr. Blumenthal, you have extensive experience in the field of international finance. And as Secretary of the Treasury, you will be the President's chief adviser in this field, as well as chairman of the important National Advisory Council on International Monetary and Financial Policies.

I happen to chair the subcommittee of this committee which deals with International Finance and Resources, so I share your interest in this area, although certainly not your expertise.

I have some questions in this area.

First, there is the issue of the indebtedness of less developed countries.

Private banks in the United States, and their foreign branches, have a large and growing exposure to loans to developing nations. Concern has been voiced about the recipients' ability to pay. Do you see any danger in this situation, and is there any appropriate government action which might help counter a potential danger?

Answer. The growing debt of a number of countries to U.S. banks, and their foreign branches, requires close monitoring by the U.S. Government to be sure that it does not lead to major economic or financial problems. As Secretary of Treasury, I will assure that such monitoring takes place. The appropriate government action is to promote the adoption of responsible policies on the part of debtor and creditor countries alike, and the provision of sound financial support for such programs.

Question. Given the heavy indebtedness of the developing countries to private lenders, is there a possibility that U.S. foreign assistance to these countries may constitute, in part, a "bailout" of private banks?

Answer. U.S. foreign assistance is extended to support specific projects or responsible development programs in recipient countries. It should not be used to "bail out" private banks.

Question. As of mid-1976, the oil producing countries of the Middle East had some $18 billion in deposits in U.S. banks and their foreign branches, much of it on short term. Do you feel this constitutes a hazard?

Answer. The United States and the oil producing countries have a common interest in stable international financial arrangements. Both they and we benefit from these deposits. I see no hazard from them for the United States.

Question. The International Monetary Fund recently approved a $3.9 billion loan to Great Britain. About $2 billion of that sum will come from the U.S. Treasury. What are the terms of that loan?

Answer. I understand that the amount which the U.S. has agreed to lend to the IMF in connection with its $3.9 billion standby arrangement with the UK is SDR 945 million—about $1.1 billion. The UK can draw on its arrangement with the IMF over the next two years, provided that the UK is meeting the terms and conditions agreed with the IMF to resolve its balance of payments problems over a medium-term period. The IMF will finance the arrangement in large part by utilization of the General Arrangements to Borrow (GAB) and the U.S. loan to the IMF is provided under these arrangements pursuant to legislation enacted by the Congress in 1962. The IMF will repay these loans over 3 to 5 years. They will bear interest equivalent to the charges on UK borrowings from the IMF, currently 4 to 6 percent, depending on the length of time the borrowing is outstanding.

Question. As Secretary of the Treasury, you will control the Exchange Stabilization Fund, which now has assets of some $3.5 billion, I believe. In your view, should this Fund be utilized to help the British prop up the value of the pound?

Answer. The Exchange Stabilization Fund (ESF) provides the financial resources with which the United States participates in a series of financial arrangements with other countries. All of these arrangements are undertaken in the national interest of the United States, the other country involved, and the stability of the international monetary system. I would oppose any use of ESF resources which sought to maintain the exchange rate of any currency above the level justified by underlying economic conditions.

Question. During recent years the World Bank has drawn criticism for heavy emphasis on loan volume, and for relatively less attention to financial soundness. What is your view as to the proper future course for the World Bank?

Answer. The World Bank must follow a course which both supports the development programs of the poorer countries and preserves its own financially sound position. Upon taking office, I will review the Bank's current plans to assess whether they conform to these criteria.

Domestic Economic Policy

As far as can be determined from press reports to date, the economic stimulus package being prepared by the new administration consists of some $30 billion in combined tax reductions and spending increases, spread over the current fiscal year and the next. A few questions about this approach:

Question. First, the package is weighted in favor of stimulus of demand, as opposed to stimulus of production. Will not this weighting risk severe inflation?

Answer. We will be very careful about this matter. Since the economy is working well under its capacity and there is no tightness in capital markets, and no evidence of significant materials shortages or other bottlenecks, we believe that policies to encourage growth will not favor inflation. As the stimulus program creates greater demand and production to satisfy it, the stimulus program can be adjusted to assure that it does not add to inflationary pressures.

Question. Second, the stimulus is to be carried forward as far as September of 1978. What evidence is there that stimulus will be needed at that late date?

Answer. We are very conscious of the need to attune the total spending program and the budget to the condition of the economy. If the economy is moving well in 1978 with lessening evidence of a need for additional stimulus, I would expect that steps will be taken to reflect this progress on the spending programs being considered. Some elements of the stimulus program have been devised precisely with elements of flexibility in them.

Question. Traditionally, Congress has attempted to compensate for automatic tax increases due to inflation by periodically enacting broad tax cuts or rebates. In view of what seems to be an exclusion of middle-class wage earners from President-elect Carter's tax reduction package this year, what effect do you feel the substantial tax increases due to inflation will have on your attempts to stimulate the economy?

Answer. The tax program, which is still being formulated in detail, by no means excludes middle-class wage earners from tax reductions and rebates. Those reductions will help to offset the increases that some suffer because of inflation. In any case, as we undertake a basic look at our tax structures, we will be keenly aware of the need to address the issue of the impact of inflation upon tax increases on those in various income groups.

Question. Third, one tax measure under consideration would give employers credit against corporate income taxes equal to 5% of their Social Security payroll tax. Mr. Hobart Rowen, writing in the Washington Post of January 9, described this proposal as "the first step toward Treasury financing of Social Security benefits." Do you believe this is wise policy, and if so, what are your reasons?

Answer. The proposal to give employers credit against corporate income taxes equal to 5% of the payroll tax is designed to provide tax relief to the business sector. It is hoped that lower taxes for business will lead to more spending to increase investment and productivity, thereby creating more private industry jobs and reducing the rate of unemployment. This particular proposal is not to be viewed as a first step toward Treasury financing of Social Security benefits. Payments to the Social Security fund would remain unchanged. It is my view that preserving the integrity of the Social Security fund is of great importance.

QUESTIONS SUBMITTED BY SENATOR HELMS

Question. As you know, the IMF agreement ratified by Congress last year calls for "firm surveillance" of member nation's actions with regard to exchange rate manipulation. The French central bank head has said that this surveillance should include domestic monetary policies which lead to balance of payments surplusses or deficits. What is your opinion of IMF surveillance of our monetary policy?

Answer. Under the amended Articles, the IMF will be charged with insuring the effective operation of the international monetary system and overseeing compliance of members with a series of obligations designed to promote an open world trade and payments system and a sound world economy. Thus, the IMF is the appropriate forum for discussion of the international implications of a broad range of international economic policies. That does not mean, however, that the Fund will have the authority to determine U.S. monetary or other national economic policies.

Question. The IMF has been selling off about 25,000,000 ounces of its gold and returning to the nations that contributed the gold in the first place. If the question comes up, would you favor returning, to the original donors, the remainder of the IMF gold stocks?

Answer. I have not yet addressed myself to the whole range of questions concerning the arrangements on gold which have been negotiated during the past few years. I will do so upon taking office, and will look specifically at the question of possible further restitutions of IMF gold.

Question. Last year, during the consideration of the IMF bill, the Secretary of the Treasury endorsed a proposal which would allow for the restoration of the freedom of Americans to enter into contracts that call for payment in gold or in dollars measured in gold—just as we can now enter into contracts calling for payment in any other commodity. Will you uphold the commitment Treasury made last year to this legislation?

Answer. As indicated in my answer to the previous question, I have not yet considered the wide variety of issues relating to gold which have been under discussion, both domestically and internationally, in the recent past. I will do so promptly upon taking office.

Question. Will it be your intention to attempt to increase the maturity of the national debt? I understand that it is just over 3 years at this time. That is a lot of federal intervention in the credit markets. Would such an increase in the maturity tend to increase or decrease the cost of capital to the private sector? To the federal government?

Answer. The strategy concerning maturities in federal debt financing must change periodically, in response to conditions in the debt markets. These markets have been unusually strong during the past year, remain generally strong now, and have permitted the Treasury to extend the maturity of the national debt without placing undue pressure on short or long term interest rates. In general, if the debt markets remain strong, extending this average maturity makes sense. The longer the maturity of the national debt, the less pressure is placed on the debt market by constant refundings of maturing short term debt.

In weaker markets, however, it may not be sound to continue these efforts to extend the maturity of the national debt. As economic activity increases and private borrowings increase in proportion, the Treasury may be advised to cut back on its use of long maturities to avoid competing unduly with those private borrowers.

Market conditions also determine whether the use of long maturities increases or decreases the borrowing costs of the private sector. For example the supply of investible funds is so large relative to today's slack demand, that using long maturities today does not increase private borrowing costs materially. This is evidenced by the present level of interest rates, which is low by standards of the past 4 years.

In addition, a Treasury policy of short term borrowing does not indirectly increase borrowing costs for the private sector. Reliance on short term maturities obviously places upward pressure on short term interest rates. In general, a rise in short term interest rates triggers rises in medium and long term interest rates, including those for private borrowers.

Lastly, using long term maturities increases the Federal Government's borrowing costs, over the short term, but may decrease them over the long term. Specifically, on any given day, short term interest rates normally are lower than long term interest rates. For a given borrowing therefore, using short term maturities results in lower interest costs for that borrowing. On the other hand, long term Treasury bonds presently can be sold at fairly low rates. Two years from now, if economic activity has increased and interest rates have followed suit, short term rates at that time conceivably could be higher than the present level of long term rates. In that event, using long term maturities now would have proved to be the cheaper two year strategy for the overall Federal borrowing program.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 1, 1977

RESULTS OF AUCTION OF 3-YEAR TREASURY NOTES

The Treasury has accepted $3,004 million of $5,886 million of tenders received from the public for the 3-year notes, Series G-1980, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	6.56%	1/
Highest yield	6.64%	
Average yield	6.62%	

The interest rate on the notes will be 6-1/2%. At the 6-1/2% rate, the above yields result in the following prices:

Low-yield price	99.839
High-yield price	99.625
Average-yield price	99.678

The $3,004 million of accepted tenders includes $736 million of noncompetitive tenders and $2,268 million of competitive tenders (including 83% of the amount of notes bid for at the high yield) from private investors.

In addition, $1,580 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for securities maturing February 15, 1977, ($1,300 million) and from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash ($280 million).

1/ Excepting 2 tenders totaling $510,000

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

For Release on Delivery

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
WASHINGTON, D.C., WEDNESDAY, FEBRUARY 2, 1977 10:00 A.M.

Mr. Chairman and members of this distinguished Committee:

It is an honor to make my first appearance before this Committee to support the President's economic stimulus program.

Mr. Schultze undoubtedly will discuss with you later today why we believe the economy needs a degree of stimulus and some of the related strategy behind our program. In addition, Bert Lance's later testimony will surely focus particularly on the budget and the effects of our stimulus program on it.

I will confine myself, therefore, to a discussion of the international economic setting in which to evaluate this program. In addition, I will describe its tax components, in detail, and more briefly go into the spending aspects. Finally I will address the likely effects of this program on the economy, with particular attention to its effects on the budget deficit and the financing of the deficit.

International Economic Considerations

Let me first turn to the international economic context within which this program has been formulated.

First, we must recognize that we increasingly participate in a global economy. American economic health is importantly affected by conditions in our export markets. The other industrialized countries are just as dependent on our economy. In turn, the developing nations are critically dependent on demands for their products from the industrialized world.

Second, just as we recently experienced a pronounced economic pause at home, a similar slowing of growth among the industrial countries has been evident. Japan and Germany are expected to grow at a slightly lower rate than in 1976; several of the other major economies -- such as the United Kingdom, France, Italy, and Mexico -- are facing even slower growth in the period immediately ahead. There is only one industrial country -- Switzerland -- which is not experiencing near record unemployment. In addition, inflation continues at levels which would be unacceptable even at full employment. Only in Germany and Switzerland is the current inflation rate below 4%.

In addition to these twin problems of unemployment and inflation, a number of nations, both industrial and developing, are becoming concerned about their ability to continue to finance current balance of payments deficits. External debts have risen dramatically. In some cases, there is little confidence in the ability of governments to maintain economic expansion, reduce unemployment, and control inflation.

In solving these problems, all countries must work together. The Carter Administration is committed to this type of international collaboration. Today, for example, it is important that the stronger countries, like the United States, Germany and Japan, work together to expand as rapidly as is consistent with sustained growth and the control of inflation.

By adopting this stimulus program, the United States will be asserting leadership and providing a better international economic climate. We will then ask the stronger countries abroad to follow suit. This program itself implicitly calls on them to undertake stimulus efforts of proportionately similar amounts to ours.

The Stimulus Program

Let me turn now to the stimulus program itself.

The tax features of the program have been designed with two particular criteria in mind: to provide a quick injection of spending into the national economy and to take a first step in the Carter Administration's long term program of tax simplification and reform.

Tax Rebate Provision

In broad terms, the immediate stimulus will be provided by a payment of $50 per capita to almost everyone. The payments are designed to be as broadly applicable as it is administratively possible to provide. First, there is a general rebate of $50 for each taxpayer and dependent included on an income tax return for 1976. For those who had little or no tax liability the rebate will generally be refundable, along the lines of the present earned income credit. In other words, the $50 per person rebate will be paid in full even though this may exceed a family's tax liability.

The only groups for whom the rebate will not be refundable will be single individuals, married couples with no dependents, or married couples with dependents, but no wage and salary income. For this group, the $50 credit will be available only to the extent of 1976 liability. Table I shows the distribution of this rebate by adjusted gross income class at 1976 levels of income. The total amount of the tax rebate is $9.6 billion distributed to more than 70 million tax return filers.

Beyond the rebates, those not required to file tax returns also will receive $50 payments. These will be made to all beneficiaries under the Social Security, supplemental security income, and Railroad Retirement programs. Thirty-six million beneficiaries will receive these payments at a total cost of $1.8 billion.

These $50 payments thus will amount to a total of $11.4 billion. They will be made this Spring in the months of April, May, and June. The total rebate payments, therefore, should fall entirely in fiscal year 1977.

Concerning one-time payments, some have argued that they have little or no stimulative effect. They argue that consumers, seeing that the payments are just temporary, will not change their spending patterns, but will instead save the entire payment.

It seems to me that the effect of a rebate depends on the condition of the economy. Under present circumstances, I think that a rebate will be rapidly spent. Admittedly, when economic conditions have been good for some time, consumer spending and saving plans are relatively stable as families adjust their spending to present and anticipated income. Under such circumstances, people receiving a "windfall" in the form of a temporary tax cut probably will spend only a portion of it, saving the rest.

But recent economic conditions have been neither good nor stable. Most families' real income expectations have been repeatedly disappointed. Even when wage increases have been achieved, inflation has rapidly eroded them, leaving many families in worse shape than they were before. This has two consequences. First: most consumers have not been able to keep their consumption spending at a level which they consider satisfactory. There is, therefore, a significant willingness to consume that the rebate program will tap. Second: because the economy is recovering, consumer confidence is also on the rise. This provides a further incentive to spend rather than save.

Tax Simplification and Reform

Another part of this package is designed not only to provide a stimulus for the economy but also to simplify the tax laws. This is the first step in our long range tax reform and simplification program.

One source of complexity under present law is the standard deduction provision. Presently the standard deduction for single people is 16 percent of adjusted gross income, but not less than $1,700 or more than $2,400. In the case of married couples the standard deduction is 16 percent of adjusted gross income, but in this case not less than $2,100 or more than $2,800. Everyone claiming the standard deduction, even though using the tax table, must make this calculation.

The proposal which the Administration is presenting would substitute a flat dollar amount of $2,400 for single people and $2,800 for married couples for this complicated set of standard deduction provisions. These are the present maximum standard deductions for single and married persons, respectively. The flat dollar standard deduction not only is easier to compute than the variable credit but also makes it possible to incorporate the standard deduction into the tax tables and rate structure. This means that there would be no separate computation of the standard deduction, as there is today. Instead, the tax tables simply will reflect it.

Even taxpayers who itemize their deductions will be able to use the tax tables, or rate structures, with the standard deduction built in. They will simply subtract from their income the excess of their itemized deductions over the flat standard deduction, and then turn to the tax tables.

In addition, the new tax tables will include built-in computations of personal exemptions and the general tax credit. Under present law, taxpayers must make all of these calculations themselves. For example, the general tax credit involves a choice between a per capita credit of $35 and an alternative credit of up to $180 based on the first $9,000 of taxable income. Yet, the new tax tables, I am pleased to say, will not require any of these calculations.

This overall change in the standard deduction represents an annual budget cost of about $4 billion. However, since these changes won't take effect until mid-year, the revenue impact in fiscal 1977 will only be $1.5 billion. In fiscal year 1978, the revenue loss is expected to be about $5.4 billion, because of refunds reflecting the catch-up effect that year.

The tax cut provided by the standard deduction change will affect only married couples with incomes of $17,500 or less or single persons earning $15,000 or less. Much of this cut, therefore, is concentrated in the lower income levels. Specifically, 65 percent of the reduction goes to those with income below $10,000. Table 4 shows the actual reduction in taxes representative taxpayers using the standard deduction. For example, a family of four with earnings of $10,000 will have its taxes reduced by $133 (from $651 to $518). Parenthetically, we expect the percentage of filers using the standard deduction to rise from approximately 69 percent to 74 percent.

These tax changes will also insure that persons at or below the poverty level will pay no income tax. Table 5 shows levels of tax-free income compared to projected poverty levels. While our program raises the tax-free level slightly above the expected poverty level in 1977, generally this will no longer be true in 1979 and thereafter.

Business Tax Reductions

To provide further stimulus for economic expansion, we also provide a component involving business tax reductions.

Each business will choose, but on a five year binding basis, between two tax credits: (1) a refundable credit of 4 percent of the employer's share of Social Security payroll taxes (currently 5.85 percent of taxable payrolls) or (2) an additional 2 percent investment tax credit (generally from 10 to 12 percent). The self employed will choose between the additional investment tax credit or 2 percent of the self employed payroll tax (currently 7.9 percent) plus, of course, 4 percent of any other payroll taxes they have. These credits will apply to equipment eligible on January 1, 1977, or to Social Security taxes incurred after that date.

We realize that businesses do not benefit uniformly from the investment tax credit. Relatively labor-intensive firms, service businesses, and non-profit institutions may not be eligible for the investment tax credit. It is partly for this reason that we have proposed an alternative credit against payroll taxes. Another reason is that it should directly encourage employment. The payroll tax credit will be fully refundable so that all businesses, whether or not they have current tax liability, can reduce their payroll costs through it.

In 1977, this feature will reduce business taxes by $2.6 billion. Of this total, $1.1 billion would reflect use of the payroll tax credit and $1.5 billion would represent use of the higher investment credit.

In general summary, the tax features of our stimulus plan have a budget cost of $13.7 billion in fiscal 1977. Most of this represents the cost of the tax rebate. In fiscal 1978, however, these tax components shift substantially and the tax budget cost in that year will drop to $8 billion. This decrease is, of course, attributable to the fact that the rebate only occurs in fiscal 1977.

Spending Components of the Stimulus Program

I will only briefly address the spending features of the program because Bert Lance will cover it later for you, and far better than I can.

The spending elements of the package were chosen on three criteria; First, and most important, the programs had to create jobs. Second, the programs had to be effective, and subject to a well administered expansion. We were not interested in creating waste, confusion, or corruption. Third, the programs had to be susceptible to reasonably rapid termination. We did not wish to mortgage large amounts of dollars of future tax revenues in the first few days of the Administration.

Within these limits, our spending program is an aggressive one:

For local public works, we recommend an increased authorization of $4 billion, to be spent over 2 years as quickly as good management allows. We are asking increased appropriations of $2.0 billion in both fiscal year 1977 and fiscal year 1978. We estimate that only $0.2 billion of this can be spent in what remains of fiscal year 1977, but this is an informed guess, not a ceiling. In fiscal year 1978, we expect a full $2.0 billion increase in outlays.

For direct job creation, we are seeking $1.0 billion in increased outlays this fiscal year, and $5.0 billion in fiscal 1978. The impact on jobs will be substantial once the spending begins to flow heavily: We project, by fiscal year 1978, an increase of 415,000 public service employment jobs and of 346,000 training and youth slots under provisions of the Comprehensive Employment and Training Act. This is an ambitious jobs program, both in its size and in the sophistication and fairness of its several elements. The Labor Department does not believe that it can efficiently manage any larger expansion in so short a time.

Finally, we propose an expansion and reform of countercyclical revenue sharing -- changes designed to distribute annually, at current unemployment rates, $1 billion more than the present system. These funds will combat unemployment by saving hard-pressed State and local governments from reducing their payrolls.

Because countercyclical revenue sharing is administered by the Treasury Department, I would like to say a word more about this element of the stimulus package:

Existing law provides for the expenditure of $1.25 billion for countercyclical revenue sharing. Under this program, $125 is distributed quarterly, plus $62.5 million for each half percentage of national unemployment over 6 percent. When national unemployment falls to 6 percent, this latter part of the program turns off. At the current national unemployment rate, about 8 percent, all funds appropriated by Congress for this program will be exhausted by April of 1977.

The program has targeted funds quite effectively. For example, three quarters of all local funds in the third quarterly payment went to governmental units with unemployment rates in excess of 8 percent.

Our economic stimulus package both expands and reforms the program. An additional $1 billion would be made available for distribution beginning in July of 1977. In addition, the program would be given a 4 year authorization, with annual appropriations. This compares to the current authority which covers only five quarters. Thus, the "trigger" would remain in place over the full business cycle, a sound precaution against any sudden downturn in the years ahead. Finally, the funding would be made more sensitive to changes in the unemployment rate. Instead of the current approach of increasing $62.5 million for every

<u>half percentage point</u> of unemployment over 6 percent, each change of <u>one tenth</u> of a percentage point in unemployment would result in an additional $30 million in funding.

For this countercyclical program, we currently estimate an increase in spending in fiscal 1977 of $500 million and in fiscal year 1978 of $600 million. If unemployment is higher than anticipated, the expenditures in fiscal 1977 might be larger than these amounts.

In summary, the spending components of our stimulus program -- for public works, public service jobs and countercyclical revenue sharing -- will cost $1.7 billion in fiscal 1977. As this spending takes hold in fiscal 1978, however, the cost will increase to $7.6 billion. When added to the tax reductions described earlier, the overall stimulus program will cost $15.5 billion this year and approximately $15.7 billion next year. Table 5 provides a tabular, line-by-line summary of these budget costs.

<u>Effects of the Stimulus Program on the Overall Economy</u>

The Administration believes that this stimulus program will have the following, general effects on our economy.

The tax rebate will almost immediately put funds into the hands of consumers, increase their spending, and thus encourage higher levels of overall economic activity. Such an immediate stimulus must be provided through a rebate because public service employment or accelerated public works cannot be expanded fast enough to achieve this objective in the few remaining months of fiscal year 1977.

In fiscal 1978 the spending programs will strike heavily at unemployment, particularly among construction workers, veterans, and minorities.

With this program, it is expected that the unemployment rate will decline to between 6.7 and 6.9 percent by the fourth quarter of 1977 and fall further in 1978, approaching the 6 percent level by the end of that year.

Also the real gross national product, given this program, should increase during calendar year 1977 by about 5-3/4 to 6 percent, as contrasted to only about 4-1/2 or 4-3/4 percent in the absence of the program.

While this program will provide the needed economic stimulus, we do not expect it to cause any significant increase in the rate of inflation. The present high unemployment rate and the substantial unused industrial capacity -- still approaching 20 percent -- indicate that inflationary pressures are subdued now and probably can remain so. Increased prices that do occur will primarily reflect the momentum for price increases which has not yet worked its way out of the economic system.

Impact of Program on Federal Budget Deficits and Credit Markets

I turn now to the effect of the economic stimulus program on the Federal budget deficits and, in turn, the effect of financing these on the capital markets. The entire federal budget is currently being reviewed by the Administration and, as a result, we cannot provide today a precise deficit figure for the fiscal year 1977. However, we believe that the fiscal year 1977 deficit will be in the range of $67 billion to $69 billion, including the effects of this stimulus proposal.

A deficit in this range, together with about $10 billion of off-budget financng, will mean a call by the Treasury on the credit market in fiscal year 1977 of $77 billion to $79 billion. Questions have been raised as to whether this prospective Treasury financing will "crowd out" other investments in the capital market.

It is true that private sector demands for funds have been rising from their recession lows since the latter part of 1975. These trends can be expected to continue in 1977 and 1978. Combining these demands with total Treasury financing requirements suggest a level of total financing in the credit market during the calendar year 1977 of nearly $300 billion.

The question, of course, is whether the supply of funds available will be sufficient to meet this demand. Our analysis indicates that the supply of funds will be ample. First, consumer savings should expand further and it is likely that saving flows to financial institutions will amount to about $150 billion. In addition, because this stimulus package is not inflationary, it appears reasonable to anticipate that throughout 1977 and 1978 commercial and Federal Reserve banks will have the resources to purchase substantial amounts of credit market instruments. These sources of funds together with those supplied by businesses, State and local governments, the Federal government, and foreign investors should meet the demand for funds without the need for substantial purchases by individuals.

In summary, my judgment is that the temporarily larger Federal deficit will not have a serious effect on the availability of financing for the private sector. Accordingly, it will have only a moderate impact on interest rates. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and the real rate of growth will not reach an unsustainable level. Thus, I do not believe that we will be confronted with a situation where Federal financing requirements crowd out private borrowers.

I thank you.

Table 1

Estimated Effects of the Administration's Flat Standard Deduction Proposal, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the $2,400/$2,800 standard deduction 1/		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	..............)
Less than 5	-616	15.6	15.6
5 - 10	-1,953	49.4	65.0
10 - 15	-1,245	31.5	96.5
15 - 20	-137	3.5	100.0
20 - 30	-1	*	100.0
30 - 50	-*	*	100.0
50 - 100	-*	*	100.0
100 or more	-*	*	100.0
Total	-3,951	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

*Less than $500 thousand or 0.05 percent.

1/ Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

Table 2

Estimated Effects of the Administration's Tax Rebate Program, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-984	10.3	10.3
5 - 10	-2,010	21.0	31.2
10 - 15	-2,223	23.2	54.4
15 - 20	-1,904	19.9	74.3
20 - 30	-1,695	17.7	92.0
30 - 50	-564	5.9	97.9
50 - 100	-169	1.8	99.6
100 or more	-36	0.4	100.0
Total	-9,585	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

Table 3

The Flat Standard Deduction Proposal for 1977:
Tax Changes for Representative Taxpayers

Filing status	Adjusted gross income	1976 law tax	Proposed 1977 tax 2/	Tax change
Single:	$ 3,000	$ 42.50	$ 0	$- 42.50
	5,000	363.50	247.50	-116.00
	7,000	714.50	584.50	-130.00
	10,000	1,331.00	1,177.00	-154.00
Joint return:	5,000	130.00	28.00	-102.00
	7,000	448.00	332.00	-116.00
	10,000	948.00	829.00	-119.00
	15,000	1,882.00	1,794.00	-88.00
Family of four:	7,000	35.00 1/	-70.00 1/	-105.00
	10,000	651.00	518.00	-133.00
	15,000	1,552.00	1,464.00	-88.00

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Assumes use of the earned income credit.

2/ The proposal would increase the minimum standard deduction to $2,400, or, for joint returns, $2,800.

Note: Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

Table 4

Tax-free Levels and Projected Poverty Levels

(dollars)

	Tax-free levels		Projected poverty levels 1/	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	2,700	3,400	3,107	3,439
Couple without dependents	4,100	4,800	4,018	4,448
Family of four	6,100	6,800	6,110	6,763

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

Table 5

Budget Costs of the Administration's Stimulus and
Tax Simplification and Reform Proposals

($ billions)

	Fiscal Year	
	1977	19
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns 1/	1.5	5.
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	0.9	2.
Other expenditures program:		
Increased countercyclical revenue sharing	0.5	[illegible]
Public service employment	0.7	3
Public works	0.2	2
Expanded training and youth programs	0.3	1
Total other expenditures programs	1.7	7
Total administration proposals	15.5	15

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 19

*Less than $50 million.

Note: Details may not add to totals due to rounding.

1/ Includes extension of the $35 general tax credit to exemptions for age and blindness.

Department of the TREASURY
WASHINGTON, D.C. 20220 TELEPHONE 566-2041
NEWS

For Release on Delivery

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE HOUSE COMMITTEE ON BANKING, CURRENCY AND HOUSING
WASHINGTON, D.C., WEDNESDAY, FEBRUARY 2, 1977 2:00 P.M.

Mr. Chairman and members of this distinguished Committee:

It is an honor to make my first appearance before this Committee to support the President's program for economic stimulus.

Mr. Schultze, in his testimony before you later, undoubtedly will discuss in detail why we believe the economy needs a degree of stimulus, what our strategy has been in formulating this program and what effects it will have on the economy. In addition, Bert Lance later will particularly address the budgeting considerations involved in the program, including its effects on the deficit. I, therefore, will confine myself to describing the international economic setting in which to evaluate this program. In addition, I will summarize its tax and spending components, and certain of its likely effects on the economy. Finally, I will provide particular detail concerning the financing of the budget deficit.

International Economic Considerations

Let me first turn to the international economic context in which this program should be viewed.

First, we must recognize that we increasingly participate in a global economy. American economic health is importantly affected by conditions in our export markets. The other industrialized countries just as dependent on our economy. In turn, the developing nations are critically dependent on demands for their products from the industrialized world.

Second, just as we recently experienced a pronounced economic pause at home, a similar slowing of growth among the industrial countries has been evident. Japan and Germany are expected to grow at a slightly lower rate than in 1976; several of the other major economies -- such as the United Kingdom, France, Italy, and Mexico -- are facing even slower growth in the period immediately ahead. There is only one industrial country -- Switzerland -- which is not experiencing near record unemployment. In addition, inflation continues at levels which would be unacceptable even at full employment. Only in Germany and Switzerland is the current inflation rate below 4%.

In addition to these twin problems of unemployment and inflation, a number of nations, both industrial and developing, are becoming concerned about their ability to continue to finance current balance of payments deficits. External debts have risen dramatically. In some cases, there is little confidence in the ability of governments to maintain economic expansion, reduce unemployment, and control inflation.

In solving these problems, all countries must work together. The Carter Administration believes strongly in such collaboration and will strive to foster it. Today, for example, it is important that those stronger countries, like the United States, Germany and Japan, work together to expand as rapidly as is consistent with sustained growth and the control of inflation.

By adopting this stimulus program, the United States will be asserting leadership and providing a better international economic climate. We will then ask the stronger countries abroad to follow suit. This program itself implicitly calls on them to undertake stimulus efforts of proportionately similar amounts to ours.

The Stimulus Program

Let me turn now to the stimulus program itself.

The tax features of the program have been designed with two particular criteria in mind: to provide a quick injection of spending into the national economy and to take a first step in the Carter Administration's long term program of tax simplification and reform.

Tax Components

In broad terms, stimulus to the economy will be provided by a payment of $50 per capita to almost everyone. This will be accomplished by a general refundable rebate on 1976 taxes of $50 for each taxpayer and each dependent. For those who have either no dependents or no earned income, this rebate will not exceed the amount of 1976 tax liability. Also, a payment of $50 per beneficiary will be made to Social Security beneficiaries, those receiving supplemental security income payments (SSI), and those receiving Railroad Retirement payments.

The $50 per person rebate and Social Security payment will amount to about $11.4 billion. The payments will largely be made this Spring and the total rebate payments should fall entirely on fiscal year 1977.

The second tax feature in the program is a simplification measure, designed to streamline the tax laws for those presently using the standard deduction. This involves enlarging the standard deduction for joint returns with incomes of $17,500 or less and single returns with incomes of $15,000 or less. The program substitutes a flat deduction of $2,400 for single people, and $2,800 for married couples, for the present complex set of standard deduction provisions.

This increase in the standard deduction will apply for the entire calendar year 1977 as well as subsequent years. However, this tax reduction cannot be reflected in lower withholding until approximately a month after the date of the enactment of the bill. We are assuming that the required withholding changes can become effective as of the first of May. Since the lower withholding will not be in effect for the first 4 months of the year, there will be either smaller tax payments or larger refunds when the individuals involved file their tax returns by April 15 of next year.

In terms of revenue loss, therefore, this simplification feature will cost $1.5 billion in fiscal year 1977 and $5.4 billion in fiscal year 1978. At current income levels, the full year effect is $4 billion.

The third tax component is a business tax reduction. We are proposing that business be given the option of a 2 percentage point increase in the present 10 percent investment credit or, alternatively, a refundable 4 percent tax credit for payroll taxes paid for Social Security (FICA) tax purposes. Businesses will have a choice but cannot take both. They will be committed to their choice for five years.

The full year effect of this business tax cut at current income levels is $2.6 billion. In fiscal year 1977 this will cost $.9 billion and, in fiscal year 1978, $2.7 billion.

To summarize, these three tax features of the stimulus proposal program represent a budget cost of $13.7 billion in fiscal year 1977. Most of this represents the cost of the tax rebate. In fiscal year 1978 the tax budget cost is expected to be about $8 billion. This decrease is, of course, attributable to the fact that the rebate is for the year 1977 only.

Spending Components

I will only briefly address the spending aspects of the program, because Bert Lance later will give you considerably more detail on them.

The spending elements of the package were chosen on three criteria: First, and most important, the programs had to create jobs. Second, the programs had to be effective, and subject to a well administered expansion. We were not interested in creating waste, confusion, or corruption. Third, the programs had to be vulnerable to reasonably rapid termination. We did not wish to mortgage large amounts of dollars of future tax revenues in the first few days of the Administration.

Within these limits, our spending program is an aggressive one:

For local public works, we recommend an increased authorization of $4 billion, to be spent over 2 years as quickly as good management allows. We are asking increased appropriations of $2.0 billion in both fiscal year 1977 and fiscal year 1978. We estimate that only $0.2 billion of this can be spent in what remains of fiscal year 1977, but this is an informed guess, not a ceiling. In fiscal year 1978, we expect a full $2.0 billion increase in outlays.

For new jobs programs, we are aiming for $1.0 billion in increased outlays this fiscal year, and $5.0 billion in fiscal year 1978. The impact on jobs will be substantial once the spending begins to flow heavily: We project, by fiscal year 1978, an increase of 415,000 jobs in public service employment and of 346,000 training and youth slots under other provisions of the Comprehensive Employment and Training Act. This is an ambitious jobs program, both in its size and in the sophistication and fairness of its several elements. The Labor Department cannot efficiently manage any larger expansion in so short a time.

Finally, we propose an expansion and reform of countercyclical revenue sharing -- changes designed to distribute, at current unemployment rates, $1 billion a year more than does the present system. These funds will combat unemployment by saving hard-pressed State and local governments from having to contract their payrolls.

Because countercyclical revenue sharing is administered by the Treasury Department, allow me to say a word more about this element of the stimulus package:

Existing law provides for the expenditure of $1.25 billion for countercyclical revenue sharing. Under this program, $125 million is distributed quarterly, plus

$62.5 million for each half percentage of national unemployment over 6 percent. When national unemployment falls to 6 percent, this latter part of the program turns off. At the current national unemployment rate, about 8 percent, all funds appropriated by Congress for this program will be exhausted by April of 1977.

The program has targeted funds quite effectively. For example, three quarters of all local funds in the third quarterly payment went to governmental units with unemployment rates in excess of 8 percent.

The President's economic stimulus package both expands and reforms the program. An additional $1 billion would be made available for distribution beginning in July of 1977. In addition, the program would be given a 4 year authorization, with annual appropriations, as compared to the current authority which covers only five quarters. Thus, the "trigger" would remain in place over the whole business cycle, a sound precaution against any sudden downturn in the years ahead. Finally, the funding would be made more sensitive to changes in the unemployment rate. Instead of the current approach of increasing $62.5 million for every half percentage point of unemployment over 6 percent, each change of one tenth of a percentage point in unemployment would result in an additional $29.2 million in funding.

For this program, we currently estimate an increase in spending in fiscal year 1977 of $500 million and in fiscal year 1978 of $600 million. If unemployment is higher than anticipated, the expenditures in fiscal 1977 might be larger than indicated.

In summary, the spending components of our stimulus program -- for public works, public service jobs and countercyclical revenue sharing -- will cost $1.7 billion in fiscal 1977. As this spending takes hold in fiscal 1978, however, the cost will increase to $7.6 billion. When added to the tax reductions described earlier, the overall stimulus program will cost $15.5 billion this year and approximately $15.7 billion next year. Table 5 provides a tabular, line-by-line summary of these budget costs.

Effects of the Stimulus Program on the Overall Economy

The Administration believes that this stimulus program will have the following, general effects on our economy.

The tax rebate will almost immediately put funds into the hands of consumers, increase their spending, and thus encourage higher levels of overall economic activity. Such an immediate stimulus must be provided through a rebate because public service employment or accelerated public works cannot be expanded fast enough to achieve this objective in the few remaining months of fiscal year 1977.

In fiscal 1978 the spending programs will strike heavily at unemployment, particularly among construction workers, veterans, and minorities.

With this program, it is expected that the unemployment rate will decline to between 6.7 and 6.9 percent by the fourth quarter of 1977 and fall further in 1978, approaching the 6 percent level by the end of that year.

Also the real gross national product, given this program, should increase during calendar year 1977 by about 5-3/4 to 6 percent, as contrasted to only about 4-1/2 or 4-3/4 percent in the absence of the program.

While this program will provide the needed economic stimulus, we do not expect it to cause any significant increase in the rate of inflation. The present high unemployment rate and the substantial unused industrial capacity -- still approaching 20 percent -- indicate that inflationary pressures are subdued now and probably can remain so. Increased prices that do occur will primarily reflect the momentum for price increases which has not yet worked its way out of the economic system.

Impact of Program on Federal Budget Deficits and Credit Markets

I turn now to the effect of the economic stimulus program on the Federal budget deficits and, in turn, the effect of these on the capital markets. The entire federal budget is currently being reviewed by the Administration and, as a result, it is impossible for us at this time to provide a precise deficit figure for the fiscal year 1977. However, we believe that the fiscal year 1977 deficit will be in the range of \$67 billion to \$69 billion, including the effect of the President's stimulus proposal.

A deficit in this range, together with about \$10 billion of off-budget financng, will mean that the Treasury will raise \$77 billion to \$79 billion of net new cash in fiscal 1977. Questions have been raised as to whether this prospective Treasury financing will "crowd out" private borrowers from the credit markets.

First, let me point out that in 1976 the Treasury also raised a large amount of net new cash -- roughly $62 billion -- and did so rather easily. Nothwithstanding this financing task, interest rates declined throughout much of the year and credit-worthy private borrowers had ready access to loans. In fact, markets were so slack last year that Treasury wisely emphasized coupon (longer term) issues in its financing program, thus successfully raising a large amount and extending the maturity of our national debt at the same time. I think that 1976 demonstrated that a large Federal borrowing program does not necessarily result in strained credit markets and rising interest rates.

One reason for this, of course, is that borrowing demand from the private sector has a much greater influence on our credit markets than does government borrowing. The President's commitment to achieving a balanced budget should reduce federal borrowing and thus ensure that private credit demands have an even greater effect on our markets in the future.

Concerning 1977, we do face a slightly less favorable overall borrowing climate than we did last year. Specifically, the 1977 deficit will be financed in a period when private credit demands are rising. The continuing housing recovery signals eventual increases in mortgage demands. Business is also expected to borrow somewhat more in 1977, as plant and equipment expenditures rise and inventories are accumulated. Consumers, too, probably will increase their credit demands, reflecting higher automobile and other durable goods sales.

We have been carefully reviewing the resultant outlook for the credit and capital markets in 1977. Our latest estimate is that total funds raised, including Federal, State and local government, corporate and other business, mortgage, consumer credit, security credit, foreign and other credits, are likely to reach nearly $300 billion in 1977. This compares with an estimated $268 billion in 1976 and $228 billion in 1975.

The funds available to meet this enlarged financing, however, seem adequate. We believe that consumer savings will expand further and that the inflows of new savings funds to institutional investors -- already running at record rates -- will expand further. We estimate that, altogether, the supply of funds from financial institutions <u>other than banks</u> -- savings and loans, mutual savings banks, credit unions, insurance companies, pension funds, mutual funds, foundations and trust funds -- will total some $150 billion in 1977, compared with an estimated $137 billion in 1976 and $108 billion in 1975.

The other half of the $300 billion required will come from two sources. First, the banking system -- which supplied $57 billion in the recovery year of 1976 and $38 billion in the recession year of 1975. In 1974, however, a healthier year for economic growth, the banking system furnished $68 billion. Our current estimate suggests that in 1977 the banking system would provide some $70 billion.

The balance will be met from a variety of traditional sources, including businesses and state and local governments, Federal Government agencies, foreign investors and households. All told, some $70-75 billion of funds should be supplied to the credit markets from these sources.

This outlook reflects our expectation that inflation rates will not rise and, therefore, that the Federal Reserve System will be able to be accomodative throughout 1977 and 1978. This, in turn, will enable commercial banks to have the resources to acquire net large amounts of credit market instruments.

My judgment is, therefore, that the large amount of financing in prospect for 1977 can be accomplished without "crowding out" and that any rise in interest rates, at most, will be quite modest. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and thus the real rate of growth will not reach an unsustainable level. I do not believe, therefore, that federal borrowing will be unduly competitive with the private sector's loan demands.

I thank you.

Table 1

Estimated Effects of the Administration's Flat Standard Deduction Proposal, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the $2,400/$2,800 standard deduction 1/		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-616	15.6	15.6
5 - 10	-1,953	49.4	65.0
10 - 15	-1,245	31.5	96.5
15 - 20	-137	3.5	100.0
20 - 30	-1	*	100.0
30 - 50	-*	*	100.0
50 - 100	-*	*	100.0
100 or more	-*	*	100.0
Total	-3,951	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

*Less than $500 thousand or 0.05 percent.

1/ Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

Table 2

Estimated Effects of the Administration's Tax Rebate Program,
Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-984	10.3	10.3
5 - 10	-2,010	21.0	31.2
10 - 15	-2,223	23.2	54.4
15 - 20	-1,904	19.9	74.3
20 - 30	-1,695	17.7	92.0
30 - 50	-564	5.9	97.9
50 - 100	-169	1.8	99.6
100 or more	-36	0.4	100.0
Total	-9,585	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

Table 3

The Flat Standard Deduction Proposal for 1977:
Tax Changes for Representative Taxpayers

Filing status	Adjusted gross income	1976 law tax	Proposed 1977 tax 2/	Tax change
Single:	$ 3,000	$ 42.50	$ 0	$- 42.50
	5,000	363.50	247.50	-116.00
	7,000	714.50	584.50	-130.00
	10,000	1,331.00	1,177.00	-154.00
Joint return:	5,000	130.00	28.00	-102.00
	7,000	448.00	332.00	-116.00
	10,000	948.00	829.00	-119.00
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Family of four:	7,000	35.00 1/	-70.00 1/	-105.00
	10,000	651.00	518.00	-133.00
	15,000	1,552.00	1,464.00	-88.00

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Assumes use of the earned income credit.

2/ The proposal would increase the minimum standard deduction to $2,400, or, for joint returns, $2,800.

Note: Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

Table 4

Tax-free Levels and Projected Poverty Levels

(dollars)

	Tax-free levels		Projected poverty levels 1/	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	2,700	3,400	3,107	3,439
Couple without dependents	4,100	4,800	4,018	4,448
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Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

Table 5

Budget Costs of the Administration's Stimulus and
Tax Simplification and Reform Proposals

($ billions)

	Fiscal Years 1977	1978
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns 1/	1.5	5.5
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	0.9	2.1
Other expenditures program:		
Increased countercyclical revenue sharing	0.5	0.6
Public service employment	0.7	3.4
Public works	0.2	2.0
Expanded training and youth programs	0.3	1.0
Total other expenditures programs	1.7	7.0
Total administration proposals	15.5	15.1

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

*Less than $50 million.

Note: Details may not add to totals due to rounding.

1/ Includes extension of the $35 general tax credit to exemptions for age and blindness.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 2, 1977

TREASURY SECRETARY BLUMENTHAL APPROVES LIMITED JONES ACT WAIVER FOR COLUMBIA GAS SYSTEM

Secretary of the Treasury W. Michael Blumenthal notified the Columbia Gas System Service Corporation (Columbia) of Wilmington, Delaware, today that he has granted a limited waiver of the Jones Act to permit transportation of liquefied natural gas (LNG) from Alaska to Everett, Massachusetts, in a foreign vessel.

Columbia had requested a waiver of the coastwise laws, commonly called the Jones Act (46 U.S.C. 883), to permit the use of the KENAI MULTINA, of the Liberian registry, to transport LNG purchased from a plant in Kanai, Alaska, to the only East Coast LNG terminal at Everett, Massachusetts, via the Panama Canal. No U.S.-flag LNG carrier capable of transiting the Canal is available.

Secretary Blumenthal approved a waiver for two voyages of the KENAI MULTINA, each to deliver approximately 700 million cubic feet of LNG, with a termination date of May 10, 1977. Columbia had requested a waiver for one year, encompassing six trips.

In his decision, Secretary Blumenthal said that, on the basis of recommendations from the Departments of Defense and Commerce and from the Federal Energy Administration, he had determined that a waiver limited in time and scope was necessary in the interest of national defense. Treasury understands that Columbia will man the KENAI MULTINA with an American crew insofar as possible.

Mr. Blumenthal said, "My decision today in no way lessens this Administration's commitment to the continued enforcement of our American cabotage laws. On rare occasions, such as the current extreme emergency, a waiver is clearly necessary in the interest of national defense."

The text of the Secretary's decision letter is attached.

Media Contact: Robert E. Nipp 566-5328

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THE SECRETARY OF THE TREASURY
WASHINGTON 20220

Dear Mr. Mankin:

This responds to your letter of January 26, 1977, requesting a temporary waiver of the coastwise shipping prohibition in the Jones Act (46 U.S.C. 883) on behalf of the Columbia Gas System Service Corporation to permit the use of a foreign vessel for the transport of liquefied natural gas from Kenai, Alaska, to Everett, Massachusetts, for a period of one year commencing on February 22, 1977.

The Federal Energy Administration (FEA) has advised me that many of the industrial corporations currently shut down because of natural gas curtailments in Columbia's service area manufacture materials necessary for the production of defense-related goods and that the requirement to restore Columbia's severely depleted reserves will result in continued industrial load curtailments through the summer storage season. FEA has, therefore, urged me to grant the requested waiver in order that the United States may fully meet its defense requirements.

The Department of Defense has advised me that there are adverse effects of the current shortage of LNG, and the potential resultant shortages of petroleum fuels, on production facilities engaged in the manufacture of items for the Department of Defense and on defense installations, and that these shortages are expected to lead to further serious curtailment of production in many industries related to the Department of Defense mobilization base. The Department of Defense has, accordingly, recommended that the requested waiver be granted, on a limited basis.

The Department of Commerce has advised me that no LNG carrier built in a U.S. shipyard is available for the transport of LNG from Alaska to Massachusetts via the Panama Canal. It, also, believes that the severity of the natural gas shortage, which threatens to shut down all types of facilities, including military facilities, justifies a limited, non-precedent setting waiver of the Jones Act.

I have, therefore, determined that a waiver on the conditions outlined below is presently necessary in the interest of national defense. Pursuant to the authority contained in the Act of December 27, 1950 (64 Stat. 1120), the restrictions against engaging in the coastwise trade imposed on the SS Kenai Multina, a Liberian-flag vessel, by Section 883 of Title 46 of the United States Code are waived for a period from this date to May 10, 1977, subject to the following conditions:

1. The vessel will be used only for transporting liquefied natural gas, in the amount of approximately 700 million cubic feet per voyage, from Kenai, Alaska, to Everett, Massachusetts.

2. The vessel will engage in no more than two voyages for this purpose.

3. The vessel will be approved by the U.S. Coast Guard for entry into the ports involved and for offloading at the terminal facilities in the destination port.

It is understood that, when engaged in the coastwise trade approved herein, the Kenai Multina will be manned insofar as practicable by a U.S. crew.

Appropriate U.S. Customs Service officials have been notified of this waiver.

Sincerely yours,

W Michael Blumenthal

W. Michael Blumenthal

Mr. Hart T. Mankin
Vice President
Columbia Gas System Service
Corporation
20 Montchanin Road
Wilmington, Delaware 19807

52-WEEK BILL RATES

February 2, 1977

HIGHEST SINCE 9/15/76	LAST MONTH
5.561%	4.728%
LOWEST SINCE	TODAY
	5.345%

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 2, 1977

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $2,930 million of 52-week Treasury bills to be dated February 8, 1977, and to mature February 7, 1978, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 3 tenders totaling $6,285,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	94.617	5.324%	5.63%
Low -	94.584	5.356%	5.66%
Average -	94.596	5.345%	5.65%

Tenders at the low price were allotted 38%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted
Boston	$ 45,825,000	$ 3,825,000
New York	4,739,980,000	2,581,580,000
Philadelphia	71,035,000	31,035,000
Cleveland	80,070,000	35,070,000
Richmond	45,840,000	40,840,000
Atlanta	10,365,000	10,365,000
Chicago	406,675,000	139,425,000
St. Louis	28,030,000	4,830,000
Minneapolis	21,175,000	11,175,000
Kansas City	16,870,000	15,370,000
Dallas	15,750,000	10,750,000
San Francisco	252,825,000	45,825,000
Treasury	20,000	20,000
TOTAL	$5,734,460,000	$2,930,110,000

The $2,930 million of accepted tenders includes $ 58 million of noncompetitive tenders from the public and $ 745 million of tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities accepted at the average price.

An additional $175 million of the bills will be issued to Federal Reserve Banks as agents of foreign and international monetary authorities for new cash.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

For Release on Delivery

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE JOINT ECONOMIC COMMITTEE
WASHINGTON, D.C., THURSDAY, FEBRUARY 3, 1977 2:00 P.M.

Mr. Chairman and members of this distinguished Committee:

It is an honor to appear before you in support of the President's program for economic recovery.

Economic Setting

We are slowly emerging from the worst recession of the last 40 years.

The recovery began reasonably well. From the first quarter of 1975 through the first quarter of 1976, the real gross national product rose by over 7 percent. Between May 1975 and May 1976 unemployment fell from 9 percent to 7.3 percent. This performance was due largely to the tax cut which Congress enacted in 1975 and to an intentional increase in inventory accumulation.

Beginning with the second quarter of 1976, however, the pace of the recovery slackened. The rate of growth in real output fell from 9.2 percent in the first quarter of the year to 3.0 percent in the fourth quarter. Unemployment rose and, since July, has fluctuated between 7.8 and 8 percent; between May and December 1976, the number of unemployed workers rose from 6.9 million to 7.5 million.

Since October, the pace of recovery appears to have improved somewhat. But the rate of growth and the level of unemployment are still plainly unsatisfactory, without stimulus, the economy will grow in calendar year 1977 at only 4-1/2 to 4-3/4 percent, and unemployment may remain significantly above 7 percent.

The current recovery does not appear to be self-sustaining. Relative to earlier recoveries, this one lacks a strong rebound in private investment. Investment will not be adequate until businessmen see a reasonable prospect of a sustained growth in consumer demand. In turn, the course of demand depends mainly on the state of consumer income; we cannot reasonably expect consumers to increase their rate of spending from current income levels.

The President's economic stimulus package has both tax cuts and expenditure increases to boost spendable income. Let me explain the strategy behind this program. First, it is a 2 year program. We wish to enable consumers and businesses to plan ahead. Second, the program contains a good deal of flexibility. It allows us either to add additional stimulus, or to cut back, to meet varying economic conditions. Third, the program promises only what can be realistically undertaken. We are proposing major increases in existing programs within a short period of time. To force more stimulus into our system, or to force it faster, would strain our ability to administer the programs in a responsible manner. Fourth, the tax rebate and the expenditure programs are temporary and will end as the economy recovers. This will permit us to fulfill our commitment to a balanced Federal budget for fiscal year 1981.

International Economic Considerations

Let me now discuss the international economic considerations associated with this program. First, we must recognize that we are now in a global economy. American economic health is importantly affected by our export markets, and other industrialized countries are just as dependent on our economy. In turn, the developing nations are critically dependent on demand for their products from the industrialized world.

Second, just as we recently experienced a pronounced economic pause at home, a slowing of growth among the industrial countries has recently been evident. Japan and Germany are expected to grow at only a slightly lower rate than in 1976. But several of the other major economies -- such as the United Kingdom, France, Italy, and Mexico -- may be facing considerably slower growth in the period immediately ahead. There is only one industrial country -- Switzerland --

which is not experiencing near record unemployment. In addition, inflation continues at levels which would be unacceptable even at full employment. Only in Germany and Switzerland is the current inflation rate below 4 percent.

In addition to these twin problems of unemployment and inflation, both industrial and developing nations are becoming concerned about their ability to finance balance of payments deficits. Their external debts have risen dramatically. For some governments, it will be very difficult to maintain economic expansion, reduce unemployment, and control inflation.

It is important that those countries which have greater economic and financial resources expand as rapidly as is consistent with sustained growth and the control of inflation. Expansion in those countries will provide stimulus for other industrialized countries and for developing countries. The United States is now encouraging the stronger countries abroad to follow our lead on stimulating their economies. This was an important theme of the Vice President's trip.

The Stimulus Program

Let me turn now to the stimulus program itself.

The tax features of the program have a two-fold purpose: to provide a quick injection of spending into the national economy and to take the first step toward a program of tax simplification and tax reform.

In broad terms, stimulus to the economy will be provided by a payment of $50 per capita to almost everyone through a general refundable rebate on 1976 taxes of $50 for each taxpayer and each dependent. For those who have no dependents or no earned income, this rebate will not exceed the amount of 1976 tax liability. Also, a payment of $50 per beneficiary will be made to Social Security beneficiaries, those receiving supplemental security income payments (SSI), and those receiving Railroad Retirement payments.

The $50 per person rebate and Social Security payment will amount to about $11.4 billion. The payments will largely be made this spring and the total rebate payments should fall entirely in fiscal year 1977.

The second tax feature in the program is a simplification measure, designed to streamline the tax laws for those presently using the standard deduction. The program substitutes for the present complex set of standard deduction provisions a flat deduction of $2,400 for single people and $2,800 for married couples, thus enlarging the standard deduction for joint returns with incomes of $17,500 or less and single returns with incomes of $15,000 or less.

This increase in the standard deduction will apply for the entire calendar year 1977 as well as subsequent years. However, the tax reduction cannot be reflected in lower withholding until approximately a month after the date of the enactment of the bill. We are assuming that the required withholding changes can become effective as of the first of May. Since the lower withholding will not be in effect for the first 4 months of 1977, there will be either smaller tax payments or larger refunds when the individuals involved file their tax returns by April 15 of next year.

In terms of revenue loss, this simplification measure will cost $1.5 billion in fiscal year 1977 and $5.4 billion in fiscal year 1978. At current income levels, the full year effect is $4 billion.

The third tax feature is a business tax reduction. We are proposing that business be given a choice between a 2 percentage point increase in the present 10 percent investment credit or a refundable 4 percent tax credit for payroll taxes paid for Social Security (FICA) tax purposes. Businesses will have a choice but cannot take both. They will be required to stay with their choice for 5 years.

The full year effect of this business tax cut at current income levels is $2.6 billion. In fiscal year 1977 this will cost $0.9 billion and, in fiscal year 1978, $2.7 billion.

To summarize, the tax features of the proposal have a budget cost of $13.7 billion in fiscal year 1977. Most of this represents the cost of the tax rebate. In fiscal year 1978 the tax budget cost is expected to be about $8 billion. This decrease is, of course, attributable to the fact that the rebate is for the year 1977 only.

Let me now discuss with you the criteria by which we chose the spending components of the program.

First, and most important, the programs had to create jobs. Second, the programs had to be effective, and subject to a well administered expansion. We were not interested in creating waste, confusion, or corruption. Third, the programs had to phase out as the economy improved. We did not wish to mortgage large amounts of future tax revenues in the first few days of the Administration.

Within these limits, our spending program is an aggressive one.

For local public works, we recommend an increased authorization of $4 billion, to be spent over 2 years as quickly as good management will allow. We are asking increased appropriations of $2.0 billion in both fiscal year 1977 and fiscal year 1978. We estimate that only $0.2 billion of this can be spent in what remains of fiscal year 1977, but this estimate is an informed guess, not a ceiling. In fiscal year 1978, we expect a full $2.0 billion increase in outlays.

For the public service and training programs, we are aiming for $1.0 billion in increased outlays this fiscal year, and $5.0 billion in fiscal year 1978. Once these programs get underway, their job creating impact will be considerable. We project, by fiscal year 1978, an increase of 415,000 jobs in public service employment, and an additional 346,000 training and youth slots under other provisions of the Comprehensive Employment and Training Act. We think it doubtful that the Labor Department can efficiently manage any larger expansion in so short a time.

Finally, we propose an expansion and reform of countercyclical revenue sharing -- changes designed to distribute, at current unemployment rates, $1 billion a year more than does the present system. These funds will combat unemployment by saving hard-pressed State and local governments from having to contract their payrolls.

Because countercyclical revenue sharing is administered by the Treasury Department, allow me to say a word more about this element of the stimulus package.

Existing law provides for the expenditure of $1.25 billion for countercyclical revenue sharing. Under this program, funds are allocated on a quarterly basis of $125 million plus $62.5 million for each half percentage of national unemployment over 6 percent. When national unemployment falls to 6 percent, this latter part of the program turns off. At the current national unemployment rate, about 8 percent, all funds appropriated by Congress for this program will be exhausted by April of 1977.

The President's economic stimulus package both expands and reforms the program. The program would be given a 4 year authorization with annual appropriations, as compared to the current authority, which covers only five quarters. Thus, the "trigger" would remain in place over the whole business cycle, a sound precaution against any sudden downturn in the years ahead. An additional $1 billion would be made available for distribution, beginning in July of 1977. Finally, the funding would be made more sensitive to changes in the unemployment rate. Instead of the current increase of $62.5 million for every half percentage point of unemployment over 6 percent, each change of one tenth of a percentage point in unemployment would result in an additional $30 million in funding.

For this program, we currently estimate an increase in spending in fiscal year 1977 of $500 million and in fiscal year 1978 of $600 million. If unemployment is higher than anticipated, the expenditures in fiscal 1977 might be larger than indicated.

Effects of the Stimulus Program on the Overall Economy

Let me outline what we believe will be the effect of this stimulus program on our economy.

The tax rebate will almost immediately put funds into the hands of consumers, and thereby increase their spending and encourage higher levels of overall economic activity. Such an immediate stimulus must be provided through a rebate because public service employment or accelerated public works cannot be expanded fast enough to achieve this objective in the few remaining months of fiscal year 1977.

In fiscal 1978 the spending programs will come into their own and strike directly at unemployment, particularly among construction workers, veterans, and minorities.

We hope that the unemployment rate will fall below 7 percent by the fourth quarter of 1977. This decline in the unemployment rate, along with normal growth in the labor force, means an increase of over 3 million jobs during 1977, up to one million of which may be attributable -- directly and indirectly -- to the stimulus program. We hope the unemployment rate will decline toward 6 percent by the end of 1978.

With this program, the real gross national product should increase during calendar year 1977 by about 5-3/4 to 6 percent, as contrasted to only 4-1/2 or 4-3/4 percent in the absence of the program. This would mean an increase in the nation's output of about $14 to $18 billion per year by the end of 1977 and $25 to $35 billion per year by the end of 1978.

While this program will provide the needed economic stimulus, we do not expect it to cause any significant increase in the rate of inflation. The present high unemployment rate and the substantial unused industrial capacity -- still approaching 20 percent -- indicate that inflationary pressures are subdued now and will not be affected appreciably by the stimulus program we are presenting. Price measures that do occur will primarily reflect past price increases which have not yet worked their way through the economic system.

Impact of Program on Federal Budget Deficits and Credit Markets

I turn now to the effect of the economic stimulus program on the reviewed byFederal budget deficits and, in turn, the effect of these on the capital markets. The entire Federal budget is currently being reviewed by the Administration and, as a result, it is impossible for us at this time to provide a precise deficit figure for the fiscal year 1977. However, we believe that the fiscal year 1977 deficit will be in the range of $67 billion to $69 billion, including the effect of the President's stimulus proposal.

A deficit in this range, together with about $10 billion of off-budget financing, will mean that the Treasury will raise $77 billion to $79 billion of net new cash in fiscal year 1977. Questions have been raised as to whether this prospective Treasury financing will "crowd out" private borrowers from the credit markets.

First, let me point out that in 1976 the Treasury also raised a large amount of net new cash -- roughly $62 billion -- and did so rather easily. Notwithstanding this financing task, interest rates declined throughout much of the year and credit-worthy private borrowers had ready access to loans. In fact, markets were so slack last year that Treasury wisely emphasized coupon (longer term) issues in its financing program, thus successfully raising a large amount and extending the maturity of our national debt at the same time. I think that 1976 demonstrated that a large Federal borrowing program does not necessarily result in strained credit markets and rising interest rates.

One reason for this, of course, is that borrowing demand from the private sector has a much greater influence on our credit markets than does government borrowing. The President's commitment to achieving a balanced budget should reduce Federal borrowing and thus ensure that private credit demands have an even greater effect on our markets in the future.

Concerning 1977, we do face a slightly less favorable overall borrowing climate than we did last year. Specifically, the 1977 deficit will be financed in a period when private credit demands are rising. The continuing housing recovery signals eventual increases in mortgage demands. Business is also expected to borrow somewhat more in 1977, as plant and equipment expenditures rise and inventories are accumulated. Consumers, too, probably will increase their credit demands, reflecting higher automobile and other durable goods sales.

We have been carefully reviewing the resultant outlook for the credit and capital markets in 1977. Our latest estimate is that total funds raised, including Federal, State and local government, corporate and other business, mortgage, consumer credit, security credit, foreign and other credits, are likely to reach nearly $300 billion in 1977. This compares with an estimated $268 billion in 1976 and $228 billion in 1975.

The funds available to meet this enlarged financing seem adequate. We believe that consumer savings will expand further and that the inflows of new savings funds to institutional investors -- already running at record rates -- will expand further. We estimate that, altogether, the supply of funds from financial institutions <u>other than banks</u> -- savings and loans, mutual savings banks, credit unions, insurance companies, pension funds, mutual funds, foundations and trust funds -- will total some $150 billion in 1977, compared with an estimated $137 billion in 1976 and $108 billion in 1975.

The other half of the $300 billion required will come from two sources. First, the banking system -- which supplied $57 billion in the recovery year of 1976 and $38 billion in the recession year of 1975. In 1974, however, a healthier year for economic growth, the banking system furnished $68 billion. Our current estimate suggests that in 1977 the banking system will provide some $70 billion.

The balance will be met from a variety of traditional sources, including businesses and State and local governments, Federal government agencies, foreign investors, and households. All told, some $70-75 billion of funds should be supplied to the credit markets from these sources.

This outlook reflects our expectation that inflation rates will not rise and, therefore, that the Federal Reserve System will be able to be accomodative throughout 1977 and 1978. This, in turn, will enable commercial banks to have the resources to acquire net large amounts of credit market instruments.

My judgment is, therefore, that the large amount of financing in prospect for 1977 can be accomplished without "crowding out" and that any rise in interest rates will be quite modest. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and thus the real rate of growth will not reach an unsustainable level. I do not believe, therefore, Federal borrowing will be unduly competitive with the private sector's loan demands.

I thank you.

# # #

Table 1

Estimated Effects of the Administration's Flat Standard Deduction Proposal, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the $2,400/$2,800 standard deduction 1/		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-616	15.6	15.6
5 - 10	-1,953	49.4	65.0
10 - 15	-1,245	31.5	96.5
15 - 20	-137	3.5	100.0
20 - 30	-1	*	100.0
30 - 50	-*	*	100.0
50 - 100	-*	*	100.0
100 or more	-*	*	100.0
Total	-3,951	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

*Less than $500 thousand or 0.05 percent.

1/ Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

Table 2

Estimated Effects of the Administration's Tax Rebate Program,
Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............ percent	...............)
Less than 5	-984	10.3	10.3
5 - 10	-2,010	21.0	31.2
10 - 15	-2,223	23.2	54.4
15 - 20	-1,904	19.9	74.3
20 - 30	-1,695	17.7	92.0
30 - 50	-564	5.9	97.9
50 - 100	-169	1.8	99.6
100 or more	-36	0.4	100.0
Total	-9,585	100.0	

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Note: Details may not add to totals due to rounding.

Table 3

The Flat Standard Deduction Proposal for 1977: Tax Changes for Representative Taxpayers

Filing status	Adjusted gross income	1976 law tax	Proposed 1977 tax 2/	Tax change
Single:	$ 3,000	$ 42.50	$ 0	$- 42.50
	5,000	363.50	247.50	-116.00
	7,000	714.50	584.50	-130.00
	10,000	1,331.00	1,177.00	-154.00
Joint return:	5,000	130.00	28.00	-102.00
	7,000	448.00	332.00	-116.00
	10,000	948.00	829.00	-119.00
	15,000	1,882.00	1,794.00	-88.00
Family of four:	7,000	35.00 1/	-70.00 1/	-105.00
	10,000	651.00	518.00	-133.00
	15,000	1,552.00	1,464.00	-88.00

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1/ Assumes use of the earned income credit.

2/ The proposal would increase the minimum standard deduction to $2,400, or, for joint returns, $2,800.

Note: Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

Table 4

Tax-free Levels and Projected Poverty Levels

(dollars)

	Tax-free levels		Projected poverty levels 1/	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	2,700	3,400	3,107	3,439
Couple without dependents	4,100	4,800	4,018	4,448
Family of four	6,100	6,800	6,110	6,763

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1/ Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

Table 5

Budget Costs of the Administration's Stimulus and Tax Simplification and Reform Proposals

($ billions)

	Fiscal Years 1977	1978
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns 1/	1.5	5.5
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	0.9	2.7
Other expenditures program:		
Increased countercyclical revenue sharing	0.5	0.6
Public service employment	0.7	3.4
Public works	0.2	2.0
Expanded training and youth programs	0.3	1.6
Total other expenditures programs	1.7	7.6
Total administration proposals	15.5	15.7

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January 26, 1977

*Less than $50 million.

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1/ Includes extension of the $35 general tax credit to exemptions for age and blindness.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

For Release on Delivery

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE SENATE BUDGET COMMITTEE
WASHINGTON, D.C., FRIDAY, FEBRUARY 4, 1977, 10:00 A.M.

Mr. Chairman and members of this distinguished Committee:

It is an honor to appear before you in support of the President's program for economic recovery.

Economic Setting

We are slowly emerging from the worst recession of the last 40 years.

The recovery began reasonably well. From the first quarter of 1975 through the first quarter of 1976, the real gross national product rose by over 7 percent. Between May 1975 and May 1976 unemployment fell from 9 percent to 7.3 percent. This performance was due largely to the tax cut which Congress enacted in 1975 and to an intentional increase in inventory accumulation.

Beginning with the second quarter of 1976, however, the pace of the recovery slackened. The rate of growth in real output fell from 9.2 percent in the first quarter of the year to 3.0 percent in the fourth quarter. Unemployment rose and, since July, has fluctuated between 7.8 and 8 percent; between May and December 1976, the number of unemployed workers rose from 6.9 million to 7.5 million.

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The President's economic stimulus package has both tax cuts and expenditure increases to boost spendable income. Let me explain the strategy behind this program. First, it is a 2 year program. We wish to enable consumers and businesses to plan ahead. Second, the program contains a good deal of flexibility. It allows us either to add additional stimulus, or to cut back, to meet varying economic conditions. Third, the program promises only what can be realistically undertaken. We are proposing major increases in existing programs within a short period of time. To force more stimulus into our system, or to force it faster, would strain our ability to administer the programs in a responsible manner. Fourth, the tax rebate and the expenditure programs are temporary and will end as the economy recovers. This will permit us to fulfill our commitment to a balanced Federal budget for fiscal year 1981.

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Second, just as we recently experienced a pronounced economic pause at home, a slowing of growth among the industrial countries has recently been evident. Japan and Germany are expected to grow at only a slightly lower rate than in 1976. But several of the other major economies -- such as the United Kingdom, France, Italy, and Mexico -- may be facing considerably slower growth in the period immediately ahead. There is only one industrial country -- Switzerland --

which is not experiencing near record unemployment. In addition, inflation continues at levels which would be unacceptable even at full employment. Only in Germany and Switzerland is the current inflation rate below 4 percent.

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I turn now to the effect of the economic stimulus program on the reviewed byFederal budget deficits and, in turn, the effect of these on the capital markets. The entire Federal budget is currently being reviewed by the Administration and, as a result, it is impossible for us at this time to provide a precise deficit figure for the fiscal year 1977. However, we believe that the fiscal year 1977 deficit will be in the range of $67 billion to $69 billion, including the effect of the President's stimulus proposal.

A deficit in this range, together with about $10 billion of off-budget financing, will mean that the Treasury will raise $77 billion to $79 billion of net new cash in fiscal year 1977. Questions have been raised as to whether this prospective Treasury financing will "crowd out" private borrowers from the credit markets.

First, let me point out that in 1976 the Treasury also raised a large amount of net new cash -- roughly $62 billion -- and did so rather easily. Notwithstanding this financing task, interest rates declined throughout much of the year and credit-worthy private borrowers had ready access to loans. In fact, markets were so slack last year that Treasury wisely emphasized coupon (longer term) issues in its financing program, thus successfully raising a large amount and extending the maturity of our national debt at the same time. I think that 1976 demonstrated that a large Federal borrowing program does not necessarily result in strained credit markets and rising interest rates.

One reason for this, of course, is that borrowing demand from the private sector has a much greater influence on our credit markets than does government borrowing. The President's commitment to achieving a balanced budget should reduce Federal borrowing and thus ensure that private credit demands have an even greater effect on our markets in the future.

Concerning 1977, we do face a slightly less favorable overall borrowing climate than we did last year. Specifically, the 1977 deficit will be financed in a period when private credit demands are rising. The continuing housing recovery signals eventual increases in mortgage demands. Business is also expected to borrow somewhat more in 1977, as plant and equipment expenditures rise and inventories are accumulated. Consumers, too, probably will increase their credit demands, reflecting higher automobile and other durable goods sales.

We have been carefully reviewing the resultant outlook for the credit and capital markets in 1977. Our latest estimate is that total funds raised, including Federal, State and local government, corporate and other business, mortgage, consumer credit, security credit, foreign and other credits, are likely to reach nearly $300 billion in 1977. This compares with an estimated $268 billion in 1976 and $228 billion in 1975.

The funds available to meet this enlarged financing seem adequate. We believe that consumer savings will expand further and that the inflows of new savings funds to institutional investors -- already running at record rates -- will expand further. We estimate that, altogether, the supply of funds from financial institutions <u>other than banks</u> -- savings and loans, mutual savings banks, credit unions, insurance companies, pension funds, mutual funds, foundations and trust funds -- will total some $150 billion in 1977, compared with an estimated $137 billion in 1976 and $108 billion in 1975.

The other half of the $300 billion required will come from two sources. First, the banking system -- which supplied $57 billion in the recovery year of 1976 and $38 billion in the recession year of 1975. In 1974, however, a healthier year for economic growth, the banking system furnished $68 billion. Our current estimate suggests that in 1977 the banking system will provide some $70 billion.

The balance will be met from a variety of traditional sources, including businesses and State and local governments, Federal government agencies, foreign investors, and households. All told, some $70-75 billion of funds should be supplied to the credit markets from these sources.

This outlook reflects our expectation that inflation rates will not rise and, therefore, that the Federal Reserve System will be able to be accomodative throughout 1977 and 1978. This, in turn, will enable commercial banks to have the resources to acquire net large amounts of credit market instruments.

My judgment is, therefore, that the large amount of financing in prospect for 1977 can be accomplished without "crowding out" and that any rise in interest rates will be quite modest. Even with the economic initiatives I have outlined, the economy will only gradually return to higher rates of capacity utilization, and thus the real rate of growth will not reach an unsustainable level. I do not believe, therefore, Federal borrowing will be unduly competitive with the private sector's loan demands.

I thank you.

# # #

Table 1

Estimated Effects of the Administration's Flat Standard Deduction Proposal, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the $2,400/$2,800 standard deduction 1/		
	Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-616	15.6	15.6
5 - 10	-1,953	49.4	65.0
10 - 15	-1,245	31.5	96.5
15 - 20	-137	3.5	100.0
20 - 30	-1	*	100.0
30 - 50	-*	*	100.0
50 - 100	-*	*	100.0
100 or more	-*	*	100.0
Total	-3,951	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

*Less than $500 thousand or 0.05 percent.

1/ Includes the effect of extending the $35 general tax credit to exemptions for age and blindness.

Table 2

Estimated Effects of the Administration's Tax Rebate Program, Distributed by Adjusted Gross Income Class

(Calendar Year 1976 Levels of Income)

Adjusted gross income class	Tax change resulting from the fifty dollar per capita rebate: Amount	Percentage distribution	Cumulative percentage distribution
($000)	(.. $ millions ...)	(............. percent	...............)
Less than 5	-984	10.3	10.3
5 - 10	-2,010	21.0	31.2
10 - 15	-2,223	23.2	54.4
15 - 20	-1,904	19.9	74.3
20 - 30	-1,695	17.7	92.0
30 - 50	-564	5.9	97.9
50 - 100	-169	1.8	99.6
100 or more	-36	0.4	100.0
Total	-9,585	100.0	

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

Note: Details may not add to totals due to rounding.

Table 3

The Flat Standard Deduction Proposal for 1977:
Tax Changes for Representative Taxpayers

Filing status	Adjusted gross income	1976 law tax	Proposed 1977 tax 2/	Tax change
Single:	$ 3,000	$ 42.50	$ 0	$- 42.50
	5,000	363.50	247.50	-116.00
	7,000	714.50	584.50	-130.00
	10,000	1,331.00	1,177.00	-154.00
Joint return:	5,000	130.00	28.00	-102.00
	7,000	448.00	332.00	-116.00
	10,000	948.00	829.00	-119.00
	15,000	1,882.00	1,794.00	-88.00
Family of four:	7,000	35.00 1/	-70.00 1/	-105.00
	10,000	651.00	518.00	-133.00
	15,000	1,552.00	1,464.00	-88.00

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Assumes use of the earned income credit.

2/ The proposal would increase the minimum standard deduction to $2,400, or, for joint returns, $2,800.

Note: Tax calculations are based on the tax rate schedules and assume the standard deduction, both for present law and under the proposal.

Table 4

Tax-free Levels and Projected Poverty Levels

(dollars)

	Tax-free levels		Projected poverty levels 1/	
	1976 law	Proposed for 1977 and thereafter	1977	1979
Single person	2,700	3,400	3,107	3,439
Couple without dependents	4,100	4,800	4,018	4,448
Family of four	6,100	6,800	6,110	6,763

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

1/ Applicable to nonfarm families. Projections assume consumer price indices of 179.11 in 1977 and 198.26 in 1979.

Table 5

Budget Costs of the Administration's Stimulus and Tax Simplification and Reform Proposals

($ billions)

	Fiscal Years 1977	Fiscal Years 1978
Rebate and social security payment program:		
Fifty dollar per capita rebate:		
Reduction of tax	8.2	
Refunds in excess of liability	1.4	
Total	9.6	
Fifty dollar payment to social security and railroad retirement beneficiaries	1.8	
Total rebate program	11.4	
Simplification and reform program:		
Replace the current law standard deduction with a flat deduction of $2,400 for single returns and $2,800 for joint returns 1/	1.5	5.5
Business tax reduction program:		
Optional increase in the investment tax credit from 10 percent to 12 percent or an income tax credit equal to 4 percent of employers' social security tax payments	0.9	2.7
Other expenditures program:		
Increased countercyclical revenue sharing	0.5	0.6
Public service employment	0.7	3.4
Public works	0.2	2.0
Expanded training and youth programs	0.3	1.6
Total other expenditures programs	1.7	7.6
Total administration proposals	15.5	15.7

Office of the Secretary of the Treasury
Office of Tax Analysis

January 26, 1977

*Less than $50 million.

Note: Details may not add to totals due to rounding.

1/ Includes extension of the $35 general tax credit to exemptions for age and blindness.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 3, 1977

RESULTS OF AUCTION OF 7-YEAR TREASURY NOTES

The Treasury has accepted $2,000 million of $4,754 million of tenders received from the public for the 7-year notes, Series A-1984, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	7.21% 1/
Highest yield	7.27%
Average yield	7.25%

The interest rate on the notes will be 7-1/4%. At the 7-1/4% rate, the above yields result in the following prices:

Low-yield price	100.217
High-yield price	99.892
Average-yield price	100.000

The $2,000 million of accepted tenders includes $680 million of noncompetitive tenders and $1,320 million of competitive tenders (including 39% of the amount of notes bid for at the high yield) from private investors.

In addition, $881 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for securities maturing February 15, 1977.

1/ Excepting 2 tenders totaling $833,000

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

FOR IMMEDIATE RELEASE
MONDAY, FEBRUARY 7, 1977
CONTACT: PRISCILLA CRANE (202) 634-5248

REVENUE SHARING DATA PUBLISHED

Data used to allocate general revenue sharing funds to all States and units of local general government for the periods extending from July 1, 1976 through December 31, 1976 (Entitlement Period Seven) and January 1, 1977 through September 30, 1977 (Entitlement Period Eight) were released by the Department of the Treasury's Office of Revenue Sharing today.

The document being released today contains final, corrected data used to allocate $3.4 billion in shared revenues for the Seventh Entitlement Period and nearly $5 billion for the eighth period. Revenue sharing funds are allocated and paid to approximately 39,000 units of State and local government on a regular basis.

Data used to allocate revenue sharing funds are provided by the U.S. Bureau of the Census for each recipient unit of government.

"The Office of Revenue Sharing regularly makes public all data used to calculate individual governments' revenue sharing allocations," Miss Jeanna D. Tully, Director of the Office of Revenue Sharing stated today.

The seven data elements used to determine the revenue sharing allocation to states for Entitlement Periods Seven and Eight have been:

1. July 1, 1975 total resident population
2. 1970 urbanized population
3. 1972 per capita income
4. 1975 State individual income tax collections
5. 1974 Federal individual income tax liabilities
6. fiscal year 1974 State and local taxes
7. fiscal year 1974 general tax effort factor
   This factor is determined by dividing the fiscal year 1974 State and local taxes of a State by that State's aggregate personal income for 1973.

The Office of Revenue Sharing has used the following four data elements to determine revenue sharing allocations to units of local general government for Entitlement Periods Seven and Eight:

1. 1973 population
2. 1972 per capita income
3. fiscal year 1975 adjusted taxes
4. fiscal year 1975 intergovernmental transfers

The 1973 population and 1972 per capita income data are estimates which were generated by the Bureau of the Census. Fiscal Year 1975 revenues data (adjusted taxes and intergovernmental transfers) were collected as part of an annual revenue sharing special survey conducted by the Bureau of the Census.

The data released today may be inspected at the Treasury Department Library at 15th Street and Pennsylvania Avenue, N.W. in Washington, D.C. or at the Office of Revenue Sharing, 2401 E Street, N.W., Washington, D.C.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 3, 1977

Secretary of the Treasury W. Michael Blumenthal notified the Tropigas International Corporation (Tropigas) of Coral Gables, Florida, today that he has granted a limited waiver of the Jones Act to permit transportation of liquefied propane gas from the U.S. Gulf Coast to the Atlantic Energy, Inc. LPG terminal in Chesapeake, Virginia, in a foreign vessel. Atlantic's distribution system serves customers in Virginia, Maryland, Pennsylvania, North Carolina, and West Virginia.

Tropigas requested a waiver of the coastwise laws, commonly called the Jones Act (46 U.S.C. 883) to permit the use of MV TROPIGAS FAR EAST, a Panamanian-flag, 29,000-ton LPG carrier. No U.S.-flag LPG carrier technically capable of carrying this cargo is presently available for charter.

Secretary Blumenthal approved a waiver for no more than five voyages of the MV TROPIGAS FAR EAST, each to deliver approximately 2800 metric tons (34,700 barrels) of LPG, with a termination date of April 30, 1977.

In his decision, Secretary Blumenthal said that on the basis of recommendations from the Departments of Defense and Commerce and from the Federal Energy Administration, he had determined that a waiver limited in time and scope was necessary in the interest of national defense.

The text of the Secretary's decision letter is attached.

Media Contact: Robert E. Nipp 566-5328

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THE SECRETARY OF THE TREASURY
WASHINGTON 20220

FEB 3 1977

Dear Mr. Cook:

This responds to your letter of January 28, 1977, requesting a temporary waiver of the coastwise shipping prohibition in the Jones Act (46 U.S.C. 883) on behalf of Tropigas International Corporation to permit the use of a foreign vessel for the transport of liquefied propane gas from the U.S. Gulf Coast to Chesapeake, Virginia, for delivery into the terminal of Atlantic Energy, Inc.

The Federal Energy Administration has advised me that many of the industrial corporations currently shut down because of severe gas curtailments in the service area of Atlantic Energy, Inc. manufacture materials necessary for the production of defense-related goods and that the requirement to restore severely depleted mid-Atlantic reserves will result in continued industrial load curtailments into the summer storage season. FEA also noted that there are at least a dozen major military installations in that service area. FEA has, therefore, urged me to grant the requested waiver in order that the United States may fully meet its defense requirements.

The Department of Defense has advised me that there are adverse effects of the current gas shortage, and the potential resultant shortages of petroleum fuels, on production facilities engaged in the manufacture of items for the Department of Defense and on defense installations, and that these shortages are expected to lead to further serious curtailment of production in many industries related to the Department of Defense mobilization base. The Department of Defense has, accordingly, recommended that the requested waiver be granted.

The Department of Commerce has advised me that none of the LPG carriers in the U.S. fleet technically capable of carrying these cargoes are presently available for charter.

Also, it believes that the critical energy shortage justifies a limited, non-precedent setting Jones Act waiver.

I have, therefore, determined that a waiver on the conditions outlined below is presently necessary in the interest of national defense. Pursuant to the authority contained in the Act of December 27, 1950 (64 Stat. 1120), the restrictions against engaging in the coastwise trade imposed on the MV TROPIGAS FAR EAST, a Panamanian-flag vessel, by Section 883 of Title 46 of the United States Code are waived for a period from this date to April 30, 1977, subject to the following conditions:

(1) The vessel will be used only for transporting liquefied propane gas, in the amount of approximately 2800 metric tons per voyage, from U.S. Gulf Coast ports to Chesapeake, Virginia.

(2) The vessel will engage in no more than five voyages for this purpose.

(3) The vessel will be approved by the U.S. Coast Guard for entry into the ports involved and for offloading at the terminal facilities in the destination port.

Appropriate U.S. Customs Service officials have been notified of this waiver.

Sincerely yours,

W. Michael Blumenthal

W. Michael Blumenthal

H. Clayton Cook, Jr., Esq.
Cadwalader, Wickersham & Taft
Eleven Dupont Circle
Washington, D. C. 20036

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE February 4, 1977

RESULTS OF AUCTION OF 30-YEAR TREASURY BONDS
AND SUMMARY RESULTS OF FEBRUARY REFINANCING

The Treasury has accepted $751 million of $2,351 million of tenders received from the public for the 30-year bonds auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	7.58%
Highest yield	7.63%
Average yield	7.63%

The interest rate on the bonds will be 7-5/8%. At the 7-5/8% rate, the above yields result in the following prices:

Low-yield price	100.530
High-yield price	99.941
Average-yield price	99.941

The $751 million of accepted tenders includes $301 million of noncompetitive tenders and $450 million of competitive tenders (including 68% of the amount of bonds bid for at the high yield) from private investors.

In addition, $391 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for securities maturing February 15, 1977.

SUMMARY RESULTS OF FEBRUARY REFINANCING

Through the sale of the three issues offered in the February refinancing, the Treasury raised approximately $4.0 billion of new money and refunded $5.2 billion of securities maturing February 15, 1977. The following table summarizes the results:

	New Issues						
	6-1/2% Notes 2-15-80	7-1/4% Notes 2-15-84	7-5/8% Bonds 2-15-02-2007	Nonmar-ketable Special Issues	Total	Maturing Securities Held	Net New Money Raised
Public	$3.0	$2.0	$0.8	$ -	$5.8	$2.1	$3.7
Government Accounts and Federal Reserve Banks	1.3	0.9	0.4	0.5	3.1	3.1	-
Foreign Accounts for Cash	0.3	-	-	-	0.3	-	0.3
TOTAL	$4.6	$2.9	$1.1	$ 0.5	$9.1	$5.2	$4.0

Details may not add to total due to rounding.

Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. February 8, 1977

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 million, or thereabouts, to be issued February 17, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,500 million, or thereabouts, representing an additional amount of bills dated November 18, 1976, and to mature May 19, 1977 (CUSIP No. 912793 G3 4), originally issued in the amount of $3,502 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,600 million, or thereabouts, to be dated February 17, 1977, and to mature August 18, 1977 (CUSIP No. 912793 J6 4).

The bills will be issued for cash and in exchange for Treasury bills maturing February 17, 1977, outstanding in the amount of $6,104 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,982 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, February 14, 1977. 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 or at the Bureau of the Public Debt on February 17, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 17, 1977. 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, or from the Bureau of the Public Debt.

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Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE February 7, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,702 million of 13-week Treasury bills and for $3,701 million of 26-week Treasury bills, both series to be issued on February 10, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 12, 1977			26-week bills maturing August 11, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.837	4.601%	4.72%	97.572	4.803%	4.99%
Low	98.828	4.636%	4.76%	97.543	4.860%	5.05%
Average	98.831	4.625%	4.74%	97.553	4.840%	5.03%

Tenders at the low price for the 13-week bills were allotted 62%.
Tenders at the low price for the 26-week bills were allotted 83%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 22,725,000	$ 19,965,000	$ 3,590,000	$ 3,590,000
New York	4,373,140,000	2,325,360,000	4,935,475,000	3,197,075,000
Philadelphia	23,295,000	23,295,000	13,325,000	13,325,000
Cleveland	52,410,000	50,510,000	119,185,000	69,185,000
Richmond	31,195,000	23,555,000	22,735,000	20,735,000
Atlanta	28,365,000	24,365,000	12,740,000	12,740,000
Chicago	301,785,000	85,405,000	298,210,000	103,110,000
St. Louis	42,240,000	27,775,000	34,545,000	19,545,000
Minneapolis	32,325,000	10,185,000	42,855,000	42,855,000
Kansas City	33,180,000	32,440,000	14,425,000	14,425,000
Dallas	48,670,000	36,670,000	10,705,000	10,705,000
San Francisco	226,940,000	42,180,000	343,370,000	193,270,000
Treasury	105,000	105,000	60,000	60,000
TOTALS	$5,216,375,000	$2,701,810,000 a/	$5,851,220,000	$3,700,620,000 b/

a/Includes $306,715,000 noncompetitive tenders from the public.
b/Includes $132,525,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Media Contact: Robert E. Nipp
566-5328
February 7, 1977

FOR IMMEDIATE RELEASE

TREASURY SECRETARY BLUMENTHAL
APPROVES LIMITED JONES ACT WAIVER FOR
PARGAS, INC. OF WALDORF, MD.

Secretary of the Treasury W. Michael Blumenthal notified Pargas, Inc. of Waldorf, Maryland, today, that he has granted a limited waiver of the Jones Act to permit transportation of liquefied propane gas from Houston, Texas, to Exxon's Bayway Refinery, Linden, New Jersey, in a foreign vessel. No U. S.-flag LPG carrier technically capable of carrying this cargo is immediately available.

Pargas had requested a waiver of the coastwise laws, commonly called the Jones Act (46 U.S.C. 883), to permit the use of the SS SINE MAERSK, of Danish registry, to make two voyages, each to deliver approximately 7,000 metric tons (86,000 barrels) of LPG. Secretary Blumenthal's waiver covered only the first of these two voyages, to be made within 15 days of today's date, since the Department of Commerce informed Treasury that a U. S.-flag vessel may become available in the near future.

Title to the propane will remain in Pargas throughout but Exxon has available special facilities needed to unload and store the LPG at Linden. The propane will be used to supply Pargas customers in New Jersey, New York, Maryland, and Pennsylvania, including those on defense installations.

In his decision, Secretary Blumenthal said that on the basis of recommendations from the Departments of Defense and Commerce and from the Federal Energy Administration, he had determined that a waiver limited in time and scope was necessary in the interest of national defense.

The text of the Secretary's decision letter is attached.

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

FEB 7 1977

Dear Mr. Donohue:

This responds to your telegram of January 31, 1977, requesting a temporary waiver of the coastwise shipping prohibition in the Jones Act (46 U.S.C. 883) on behalf of Pargas, Inc. of Waldorf, Maryland, to permit the use of a foreign vessel for the transport of liquefied propane gas from Houston, Texas, to Linden, New Jersey.

The Federal Energy Administration has advised me that many of the industrial corporations currently shut down because of severe gas curtailments in the Pargas marketing area manufacture materials necessary for the production of defense-related goods. FEA also noted that there are at least three dozen military installations in that area which use natural gas. FEA has, therefore, urged me to grant the requested waiver in order that the United States may fully meet its defense requirements.

The Department of Defense has advised me that there are adverse effects of the current gas shortage, and the potential resultant shortages of petroleum fuels, on production facilities engaged in the manufacture of items for the Department of Defense, and on defense installations, and that continued shortages are expected to lead to further serious curtailment in many industries related to the Department of Defense mobilization base, thus resulting in continued, if not increasing, adverse impact on Department of Defense programs and readiness.

The Department of Commerce has advised me that none of the LPG carriers in the U.S. fleet technically capable of carrying these cargoes is presently available for charter. However, it also states that such a U.S.-flag vessel may be available before completion of the first of the two proposed voyages of the foreign vessel.

I have, therefore, determined that a waiver on the conditions outlined below is presently necessary in the interest of national defense. Pursuant to the authority contained in the Act of December 27, 1950 (64 Stat. 1120), the restrictions against engaging in the coastwise trade imposed on the SS SINE MAERSK, a Danish-flag vessel, by Section 883 of Title 46 of the United States Code are waived for a period of fifteen days from this date, subject to the following conditions:

(1) The vessel will be used only for transporting liquefied propane gas, in the amount of approximately 7,000 metric tons per voyage, from Houston, Texas, to the Bayway Refinery at Linden, New Jersey.

(2) The vessel will engage in no more than one voyage for this purpose.

(3) The vessel will be approved by the U.S. Coast Guard for entry into the ports involved and for offloading at the terminal facilities in the destination port.

Should the U.S.-flag vessel reported by the Department of Commerce not be available at the completion of the one voyage of the SS SINE MAERSK, the Department of the Treasury will consider extension of this waiver to permit a second voyage of the SS SINE MAERSK.

Appropriate U.S. Customs Service officials have been notified of this waiver.

Sincerely yours,

W. Michael Blumenthal

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NEWS

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NAC REPORTS ON INTERNATIONAL MONETARY-ECONOMIC DEVELOPMENTS

The Treasury Department has released the annual report of the National Advisory Council on International Monetary and Financial Policies (NAC) for the fiscal year ended June 30, 1976.

The 309-page report provides detailed information on international monetary, economic and financial developments and the relationship of those developments to policies and programs of the United States.

Included is coverage of global economic trends; the evolution of relationships among the developed and developing countries; U.S. support of the international development lending institutions, such as the World Bank, Inter-American Development Bank, and the Asian Development Bank, and significant events in international monetary matters, foreign trade policy and finance, foreign investment, and policies and problems involving foreign indebtedness to the United States.

Annexes of the report provide statistical material on the U.S. balance of payments, foreign assistance, and other U.S. Government and international programs.

The NAC is chaired by the Secretary of the Treasury. Other members of the NAC at the end of fiscal year were the Assistant to the President for Economic Affairs, the Secretaries of State and Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the President and Chairman of the Board of Directors of the Export-Import Bank of the United States. Details on the organization, functions and operations of the Council are contained in Appendix A to the report.

Compiled and edited by Robert S. Watson, the Secretary of the Council, the report is available from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402. Price $3.75.

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95th Congress, 1st Session - House Document No. 95-67

COMMUNICATION

FROM

THE SECRETARY OF THE TREASURY

the National Advisory
Council on international
monetary and
financial policies
ANNUAL REPORT
to the President
and to the Congress
July 1, 1975
June 30, 1976

JANUARY 31, 1977.—Referred to the Committee on Banking, Finance and Urban Affairs and ordered to be printed with illustrations.

LETTER OF TRANSMITTAL

THE SECRETARY OF THE TREASURY
WASHINGTON

January 7, 1977

Dear Mr. Speaker:

As Chairman of the National Advisory Council on International Monetary and Financial Policies, I am pleased to transmit herewith the Council's Annual Report covering the period July 1, 1975 - June 30, 1976.

This report includes, in accordance with section 4(b) of the Bretton Woods Agreements Act, as amended, an account of the participation of the United States during this period in the International Monetary Fund and the International Bank for Reconstruction and Development, together with appropriate data and material concerning the operations and policies of the Fund and Bank. Similar information is provided with respect to the International Development Association, the International Finance Corporation, the Inter-American Development Bank, and the Asian Development Bank, in accordance with legislation authorizing U.S. participation in these institutions. The report also includes information required to be submitted by the International Financial Institutions Act of 1970 (P.L. 91-599).

Copies of the report are also being submitted to the President and to the President of the Senate.

Sincerely yours,

William E. Simon
Chairman, National Advisory Council
on International Monetary and
Financial Policies

The Speaker of the House
of Representatives
Washington, D. C. 20515

Enclosure

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I. FOREWORD

FISCAL YEAR 1976 IN REVIEW

Fiscal year 1976 witnessed continuing high levels of activity for the National Advisory Council on International Monetary and Financial Policies (NAC) as the world economy emerged from the trough of the worst recession it had experienced since the end of World War II. During this fiscal year—which also marked the Thirtieth Anniversary of the first meeting of the National Advisory Council on August 21, 1945—the members and staff of the Council were heavily engaged with major developments in international monetary affairs, an acceleration in the tempo of the programs of the International Monetary Fund (IMF) and the international development lending institutions (IDLIs) and intensified activities relating to significant policies and issues in foreign trade and trade finance, foreign investment and foreign indebtedness to the United States. This Annual Report of the Council places particular emphasis on the relationships between the significant international economic and financial developments of fiscal year 1976 and relevant policies and programs of the United States.

The varying economic and financial pressures experienced as many countries moved from recession to the recovery and expansion phases of the cycle and the impact of these pressures on the economic growth rates and the balance of payments positions of the industrialized and developing nations are discussed in Chapter II of this Report. In addition, that Chapter contains an analysis of developments relating to commodities in the world economy with special attention to the intensive discussions of commodities and commodity problems which took place in several international forums during the fiscal year. Chapter II of the Report also discusses the evolving relationships between the developing and the developed countries in the continuing "North-South Dialogue." Significant international conferences dealing with the problems of the developing countries, such as the Fourth meeting of the United Nations Conference on Trade and Development (UNCTAD), the sessions of the Joint World Bank and International Monetary Fund Ministerial Committee on the Transfer of Resources to Developing Countries (Development Committee) and the meetings of the newly created Conference on International Economic Cooperation (CIEC) are also covered.

The successful culmination of the long and complex negotiations for the reform of the international monetary system and the agreements reached at the January 1976 meeting of the Interim Committee of the International Monetary Fund in Jamaica are highlighted in the third Chapter of this Report. This Chapter also reviews in some detail the operations of the International Monetary Fund in its central role in meeting world financing needs arising from the combined impact of high oil prices, inflationary pressures, and recovery from the severe global economic recession. Foreign exchange and gold market developments and the evolution of the United States balance of payments position during fiscal year 1976 are also surveyed briefly in this Chapter of the Report.

The United States continued, during fiscal year 1976, its active support of the international development lending institutions (the World Bank and its affiliates, the Inter-American Development Bank and the Asian Development Bank) and provided nearly $700 million as its contribution to the resources of these institutions for fiscal year 1976 and nearly $750 million as our contribution for fiscal year 1977. Chapter IV reviews these developments and the record levels of development lending by these institutions (IDLIs) during the fiscal year. Chapter IV also discusses important policy issues relating to each of the institutions and concludes with comments on a number of topics of particular concern to the United States such as our share in the procurement of goods and services under loans by the IDLIs and our interest in ensuring that their programs accord closely with the needs of the developing countries within the framework of international economic cooperation and stability.

The remaining Chapters of this Report review major policies, programs and issues in foreign trade and foreign trade financing, foreign investment, and foreign indebtedness to the United States Government.

FUNCTIONS AND ORGANIZATION OF THE NATIONAL ADVISORY COUNCIL (NAC)

The National Advisory Council on International Monetary and Financial Policies (NAC), which traces its origins to the Bretton Woods Agreements Act of 1945, is currently governed by the provisions of Executive Order 11269 of February 14, 1966 and related Executive Orders and legislation which prescribe that the "Council shall coordinate, by consultation or otherwise, so far as is practicable, the policies and operations of the representatives of the United States on" . . . the International Monetary Fund (IMF); the International Bank for Reconstruction and Development (IBRD) and its affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC); the Inter-American Development Bank (IDB); and the Asian Development Bank (ADB); . . . "the Export-Import Bank of Washington and all other agencies of the Government, to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transaction. . . ." These functions ". . . shall be deemed to include the authority to review proposed individual loan, financial, exchange, or monetary transactions to the extent necessary or desirable to effectuate the coordination of policies . . ."

The NAC submits an annual report on its activities to the President of the United States and to the United States Congress. It also prepares special reports to the President and Congress on significant monetary and financial topics such as proposed replenishments of the international financial institutions, debt matters and similar issues involving important international monetary and financial affairs. Much of the material contained in the Council's annual reports is compiled in response to the expressed interests of the United States Congress. In particular, the Appendices of the report provide descriptions of the development loans authorized by the international development lending institutions (IDLIs) during the fiscal year, plus an account of Latin American defense expenditures. A large body of statistical material on the United States balance of payments, foreign assistance and other financing programs, and the operations of the IDLIs during the fiscal year is also included in the Appendices to this Report.

The National Advisory Council consists, at the Principals level, of the Secretary of the Treasury (*Chairman*), the Assistant to the President for Economic Affairs (*Deputy Chairman*), the Secretaries of State and Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the President and Chairman of the Board of Directors of the Export-Import Bank of the United States. The Council is also served by a Committee of Alternates (at the Assistant Secretary level) empowered to act for the Principals. The NAC Principals and the NAC Alternates meet as necessary to deliberate such major policy and program matters as may require their attention.

Most of the day-to-day work of the Council is conducted by its Staff Committee, comprised of economists, lawyers, and professional and technical personnel from the NAC member and participating agencies. The NAC Staff Committee meets at least weekly (or more frequently as may be necessary) to review proposed international monetary and financial policies, issues and transactions. Representatives of numerous other agencies of the Government, including the Departments of Defense and Agriculture, the United States Executive Directors of the international development lending and financial institutions, the Agency for International Development (AID), the Council on International Economic Policy (CIEP), the National Security Council (NSC) and the Office of Management and Budget (OMB), participate in the work of the NAC on a regular basis. The NAC establishes *ad hoc* working groups, as needed, to consider particular policies and issues in depth and to make recommendations to the Council.

The Secretary of the NAC, assisted by a small professional and technical staff, is provided by the Treasury Department. Further details on the organization, functions and operations of the NAC, including the texts of relevant Executive Orders and legislation, are contained in Appendix A of this Report.

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(**Note:** This Annual Report of the Council covers the period July 1, 1975 to June 30, 1976. To the extent practicable, developments during the Transition Quarter (July 1, 1976 to September 30, 1976) are also discussed in the narrative section of the Report. Statistical data for the Transition Quarter will be included in the next Annual Report of the Council.)

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II. INTERNATIONAL ECONOMIC AND FINANCIAL DEVELOPMENTS DURING FISCAL YEAR 1976

- During fiscal year 1976 the world economy moved out of the trough of the worst recession experienced since the end of World War II with many of the major countries entering the recovery and expansion phases of the cycle.

- The balance of payments position of the industrialized countries as a group is forecast to deteriorate during calendar year 1976, with the deficit finding its counterpart in an $8 billion improvement in the balance of payments of the developing countries, an increase of OPEC member countries surplus by $3 billion and a decline of about $3 billion in the payments deficits of the non-market countries of Eastern Europe and China.

- The major industrialized oil consuming countries agreed on a long-term cooperative international energy program in January, 1976, providing for coordination of national efforts and cooperative measures in conservation, accelerated production of new energy, and research and development aimed at reducing oil import dependence.

- Commodity policy was in the forefront of several major international conferences during fiscal year 1976 with the United States putting forward major initiatives in this area including establishment of producer/consumer forums for all key commodities to promote market efficiency, growth and stability and, a major international effort to promote raw materials resource development in the developing countries. Agreement was also reached during the fiscal year to liberalize the International Monetary Fund's Compensatory Financing Facility.

- The United States participated actively in the evolving "North/South Dialogue" between the developed and developing countries in such international forums as the Seventh Special Session of the United Nations General Assembly, the newly created Conference on International Economic Cooperation (CIEC) and its four Commissions, the UNCTAD IV Session in Nairobi, Kenya, and the IBRD/IMF Development Committee.

- Among the significant issues dealt with by the United States in these forums were: commodity stabilization; trade negotiations; investment and multi-national corporations; resource and technology transfers and foreign debt.

OVERVIEW

Recovery and Inflation

By the beginning of fiscal year 1976, the world economy as a whole was nearing the trough of the worst recession experienced in post-World War II history but the strength of the potential for recovery and expansion remained unclear. The last half of fiscal year 1975 had witnessed negative real growth of some 4 percent in the industrialized countries as a group with nearly 5 percent negative growth being registered in the major economies. The smaller industrial countries, lagging behind in the recession, experienced negative real growth on the order of from 1 to 2 percent during this period.

Most of the industrialized countries turned to the United States to lead the recovery and hence, to a substantial degree, were counting on export-led recoveries. By the beginning of fiscal year 1976, only two of the major industrialized economies—Japan and the United States—had entered the recovery phase of the cycle. Recoveries in these two countries, soon to enter the expansion stage, spilled over to other industrial countries by way of both direct effects such as expanded trade and indirect psychological influences. The American upswing clearly affected confidence levels among European businessmen and consumers. The world recession had been sharp, by historical standards, in large part because of the massive inventory adjustments which took place in the major countries. These inventory adjustments, however, also sowed the seeds for the recovery and expansion stages of the cycle which appeared during fiscal year 1976.

The smaller industrial countries experienced real growth rates which were somewhat lower than those projected for the major industrial countries in fiscal year 1976. These smaller countries felt the recession in the major industrial nations through their external sectors only after a considerable time delay and they thus lagged by some half year or so behind the economic downturn in the larger countries. Many of the smaller industrial countries attempted to insulate their domestic economies by financing deficits through market borrowings and reserve drawdowns rather than by sharply restraining domestic demand in the presence of weak export sectors. Belated recognition of the strength and length of the recession has led to a restructuring of domestic policies in most of the smaller industrial countries because of the essentially unsustainable magnitudes of the external deficits which would otherwise result. Some of these countries are still, however, struggling to avoid such policy restructuring because they are in a period of sensitive political transition. It is nonetheless worthy of note that the choice of policy mixes by these countries had the effect of dampening the domestic impact of the world recession, albeit at the cost of increased foreign indebtedness.

During the last half of calendar year 1975, recovery became statistically more evident as the industrial world experienced real growth of some 4.3 percent, with the largest OECD members expanding at a 5.0 percent annual real rate of growth. The turn of the year brought with it increased recognition that the forces of economic recovery were indeed picking up speed and strength. In some countries the recovery was led by inventory rebuilding and by increased consumer expenditures as the extraordinarily high savings rates of the 1973 to 1975 period fell to more normal levels. In other countries, such as Japan, the recovery was primarily export led. Generally speaking, investment expenditures remained relatively low by historical standards, following roughly two years of negative real investment. One direct result of these real investment decumulations has been that plant and equipment capacity has not expanded at normal rates and, after adjustment for depreciation and the inefficiencies of existing capacity brought about by the effects of higher oil prices on relative factor inputs, productive capacity has probably actually declined over the last year or so. The consequence of this decline is that room for noninflationary expansion is more limited than it was in other recovery periods. The danger zone, where inflationary conditions or bottleneck situations in some industrial sectors prevails, may also be reached more quickly than it has during previous cycles.

The threat of renewed inflationary pressures developing from excessively rapid expansion was clearly recognized by the leaders of the seven major industrial countries at the June 1976 Economic Summit Conference in Puerto Rico. Inflation subsided during the first half of fiscal 1976 but, even with this improvement, inflation rates remained substantially in excess of acceptable levels. The strength of the recovery and expansion during the last half of fiscal year 1976 began to affect inflationary pressures as cost-of-living increases quickened in a number of the major countries between January and June 1976.

World Balance of Payments Developments

The rapid economic expansion which occurred in most of the industrial world was reflected in a return to sizeable current account deficits for the industrial countries as a group in the first half of calendar year 1976. As a consequence, the deficits of the developing and the non-market countries declined significantly, although remaining at high levels, while OPEC member countries, in the aggregate, experienced current account surpluses somewhat above calendar year 1975 levels.

The dramatic shifts in the external positions of the major industrial countries during calendar 1975 toward larger current account surpluses or smaller deficits were, to a large extent, the result of both recession-induced reductions in final import demand and major adjustments in inventory positions. Under these circumstances, a dramatic swing in the opposite direction gives way to expansion. For example, the United States balance of payments position shifted from a small current account deficit in 1974 to surplus in 1975 and back to near balance in the first half of calendar year 1976. A swing in the United States current account balance between calendar years 1975 and 1976 on the order of $12 billion is anticipated.

Since the depth and severity of the respective domestic recessions differed significantly among the industrial countries, current account balances for calendar year 1975 varied widely, ranging from a surplus position of $12 billion for the United States to a deficit of $5 billion for Canada. The external positions of the industrial countries (current account balances, including official transfers) are forecast to be much less disparate during calendar year 1976.

One result of the more even distribution of surpluses and deficits among the industrial countries may be that financial markets are less likely to single out "problem" countries as being particularly less "creditworthy" on the basis of the absolute size of payments deficits. Attention is more likely to be focused on the aggregate external debt burdens of a country or its probable debt service requirements—clearly more rational criteria than the simple magnitude of deficits. Several OECD countries may find it more difficult to obtain the financing they seek during calendar 1976 and will be under much heavier pressure to reduce their deficits. The expected "more even distribution" of balances in 1976 is in part a reflection of adjustment policies but, as time passes, adjustment in the weaker countries will increasingly shift the deficits to those countries better able to finance them.

There is not likely to be any financing problem for the OECD area in the aggregate during calendar year 1976 although some individual countries may be facing potential difficulties. For some, the problems stem from attempts during 1974 and 1975 to maintain employment and real growth in the presence of the worldwide recession; for others, the cause is inadequate adjustment to higher oil prices, and for still others, failure to permit exchange rates to adjust to market conditions with a resulting loss in competitiveness, and for a final group, the problems arise from accumulated external debt.

An important factor overlooked by focusing on current balances is the necessary amortization of external debt. In terms of absolute figures this is particularly important. The reliance on external financing by some of the smaller industrial countries in 1974 and 1975 was quite significant in a number of individual cases. Thus, such countries were faced with higher levels of debt and higher debt repayment requirements.

Current projections suggest that perhaps eighteen OECD member countries will experience current account deficits this year but for the large majority of these countries normal capital market financing, official borrowings, and the use of reserves will provide adequate external finance to cover the deficits. As fiscal year 1976 closed, there were half a dozen countries which might face some financing difficulties, although their access to private markets or international institutions had not yet been exhausted.

The counterpart of the sharp deterioration in the aggregate OECD external position is expected to be found in an improvement of about $8 billion in the current balance deficits of the non-oil exporting developing countries; an increased OPEC surplus of perhaps by $3 billion; and a decline of perhaps $3 billion in the deficits of the non-market economies of Eastern Europe and China.

Increased demand for raw material imports reflecting the strength of the recovery in the industrial world is likely to result in both higher volumes and prices for exports from the non-oil exporting developing countries. In light of external debt limitations a number of the developing countries have recently accepted more realistic growth targets which will result in lower import growth. Unfortunately, oil import prices will reflect last year's OPEC price increase. The favorable shift in terms of trade (other than oil) and external demand thus may produce a reduction of perhaps $8 billion in the aggregate deficit positions of the non-oil producing developing countries. This is not, however, likely to be equally spread among these countries.

The net improvement in the external position of the non-oil developing countries as a group may camouflage financing difficulties of individual countries. Additional comments on the balance of payments outlook for the developing countries are contained in a subsequent section of this Chapter.

Another beneficiary of the recovery in the industrial countries will be OPEC members, as recovery leads to increased demand for oil imports. OPEC members have increased imports more rapidly than had been expected with the result that more OPEC members are now expected to be in deficit and others to have very small surpluses in calendar year 1976. OPEC member governments are becoming increasingly

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aware of expenditure restraints and a number of countries have publicly reduced government spending plans and are thus likely to be experiencing lower import growth rates than had been projected in 1974 and 1975. Further comments on current account trends for OPEC members may be found later in this Chapter.

The transformation of the Communist countries from essentially balanced external positions to substantial trade deficits during the past two years has been an increasingly important factor in the world economy. It is currently estimated that the non-market economies of Eastern Europe, the Soviet Union and the People's Republic of China had substantial trade deficits with the West during calendar year 1975. Perhaps as much as a $10 billion deficit on current account was financed by the West (including OPEC) last year. While being important export markets, these countries have also become heavy borrowers in the Euro-currency medium-term credit and bond markets and the sums of Western financial capital involved—both directly through markets and indirectly through official trade credits—are substantial.

Official Reserve Positions

The level of gross official international reserves of IMF member countries and Switzerland rose some $6.9 billion, or 3 percent, during calendar year 1975. The growth in reserves accelerated in the first half of calendar 1976 as gross international reserves increased $10.9 billion—an annual rate of growth of over 9 percent—to a level of $237.9 billion (See Table 1).

Balance of Payments Position of the Developing Countries

In 1967, the aggregate current account deficit of the non-OPEC developing countries (excluding Israel and Southern Europe) was $6.3 billion and six years later, in 1973, the aggregate deficit of these countries was $8.6 billion. During this seven-year period, the average deficit for this group of countries was $7.6 billion with the largest deficit—$10.4 billion—having been recorded in 1971.

During calendar years 1974 and 1975, this historic trend of gradually rising deficits was broken abruptly by the twin shocks of higher oil prices and severe recession among the industrial economies. The aggregate deficits for the developing countries in calendar years 1974 and 1975 were on the order of $27 billion and $35 billion respectively.

As a consequence of the rapid economic expansion now under way in the industrial world coupled with domestic policy adjustments by the developing countries, their aggregate current account deficit is expected to decline to about $27 billion in calendar 1976, or about $8 billion less than in calendar year 1975. Nevertheless, this deficit is still large.

The increased deficits for the developing countries reflect: (1) markedly higher import bills for oil and related goods, (2) the impact of recession in the industrialized world exacerbated by higher oil prices, which resulted in stagnant exports by developing countries to the industrial countries; and (3) the consequences of their own policy responses, particularly attempts to maintain economic growth rates. The situation was further complicated by the necessity of adjusting simultaneously to structural problems associated with the rise in oil prices and to cyclical problems associated with the world recession.

The deficits of the developing countries have so far been financed without grave difficulties. In calendar 1975, in addition to such "traditional" flows as official bilateral and multilateral assistance and private direct investment flows, about $5 billion was provided in the form of loans and grants from OPEC member countries. These OPEC flows only partially offset the more than

TABLE 1.—*Official Reserves of IMF Member Countries and Switzerland*
[$ Billions]

	1972	1973	1974	1975	1976 March	1976 June
	(end of year)					
Total Reserve Assets	159.1	183.7	220.5	227.4	234.0	237.9
Gold Stock	38.7	43.0	43.5	41.6	40.9	40.5
SDR	9.4	10.6	10.8	10.3	10.2	10.0
Reserve Position in Fund	6.9	7.4	10.8	14.8	16.7	18.8
Foreign Exchange	104.1	122.6	155.3	160.8	166.2	168.5
(U.S. Liabilities)	61.5	66.8	76.7	80.3	82.3	85.3

Source: *International Financial Statistics*, IMF.

$10 billion increase in the *direct* cost of developing country oil imports since 1973 (although this impact was not distributed among developing countries in proportion to costs). Credits, including the Oil Facility, also provided $2 billion and $1 to $2 billion of financing came from a drawdown of reserves. The remainder of the developing countries' deficit was financed from private sector sources, at the unprecedented rate of $9 to $10 billion, largely in the form of commercial bank loans (including Euro-borrowing).

A number of the higher-income developing countries relied heavily on the private banking system to reduce the adverse effects of these developments. Most of these countries have well-established credit ratings and were able to obtain the additional amounts needed without serious difficulty. Moreover, even some of the less credit-worthy developing countries obtained significant amounts of private credit and a number of them, particularly the poorer, were able to secure enough official capital on concessional terms to finance their deficits.

These greatly expanded flows of capital to the non-oil developing countries, in the aggregate, offset the balance-of-payments deterioration caused by the recession and provided time to allow the adjustment to the structural impact of oil prices to take a form less abrupt than severe cutback in imports. The combined impact of higher oil costs and recession, however, slowed economic growth in the developing countries. From 1970 to 1973, the average growth rate of the non-oil developing countries was about 6 percent. For 1975 and 1976, the rate of growth for these countries is estimated at about 4 percent by the World Bank.

This reduction in growth rates should prove temporary, at least to the degree that longer-term structural problems are met. In any case, the decline in growth rates has been somewhat more pronounced in the case of the higher-income developing countries, mainly because this group of countries had advanced more rapidly in the 1970–1973 period and is more closely aligned to the world economy.

Although the aggregate deficit of the non-oil developing countries is projected to decline by about $8 billion in calendar year 1976, the deficit will still be large ($27 billion) by historical standards. Net borrowing from private capital markets is continuing, in part because many countries are permitting reserve levels to rise substantially after the decline in 1975—the only year in more than a decade during which developing country reserves declined. Assuming OPEC capital flows to developing countries continue at the level attained in 1975 (about $5 billion on a net basis), total bilateral and multilateral official flows to the developing countries should be on the order of $20 billion in 1976. This would leave a $7 billion aggregate deficit, plus an amount equivalent to the increase in reserves, to be financed (net) through a combination of IMF credit, direct investment and borrowing in private capital markets.

As already noted, private capital flows have played a significant role in financing the deficits of the developing countries. Total claims by banks in the United States on non-oil developing nations rose by about $6 billion in calendar year 1975. While the bulk of these credits was of a short-term character, developing countries also received a significant flow of longer-term funds through the Euro-currency market, with publicized Euro-credits to the non-oil developing countries amounting to $7.7 billion (gross) in calendar 1975, as compared with $1.9 billion in calendar year 1972. In 1975, Euro-currency credits to developing nations typically carried interest spreads of 1.5 percent to 2 percent above the London Interbank Offered Rate (LIBOR) and maturities of from five to seven years.

During calendar year 1976, private capital markets continued to provide a substantial flow of funds to the developing countries, but the net flow is expected to decline from the high levels of 1974 and 1975. In the first half of 1976, United States bank claims on these countries increased by approximately $3 billion, and publicized Euro-credits amounted to $3.5 billion (gross).

Although the record of the first half of calendar year 1976 does not suggest that financing problems will arise in the aggregate, individual developing countries may experience difficulties in adjusting their economies and the low-income countries will continue to pose a special problem in this regard. Most of these countries have had very low rates of growth in recent years and depend heavily on concessional resource flows from abroad. The absolute magnitude of their deficits is not large, but increased bilateral and multilateral assistance may have to be directed toward these countries in particular.

While the calendar year 1976 deficit of the non-oil developing countries appears likely to be financially manageable, continuation of large current account deficits has implications (particularly for external debt and growth) which extend beyond the short-term. These countries need to make internal adjustment commensurate with structural changes and to modify the level and composition of their imports to maintain the momentum of development efforts. Inappropriate or ineffective policies will impair their long-term prospects for economic growth.

OPEC Current Account Trends

The current account surplus of OPEC members in calendar year 1975 (excluding official transfers) fell to $41.1 billion, as compared with the $72 billion surplus recorded in calendar year 1974. The 1974 surplus, on a payments basis, was $60.3 billion owing to lags in payments by the oil companies of $12 billion. In 1975, oil companies' liabilities were reduced $1 billion, making the surplus on a payments basis $42.1 billion.

Oil revenues were down about $10 billion in calendar year 1975, while imports by the oil exporting countries rose by nearly $20 billion. At the same time, total service and private transfer payments increased only slightly as substantially greater freight and insurance payments, workers' remittances, and fees paid for foreign technology and services were almost fully offset by increased investment receipts.

Estimates of the OPEC current account position for 1974–1976 are contained in Table 2.

Fifty percent of the aggregate OPEC current account surplus last year accrued to Saudi Arabia while Kuwait and the United Arab Emirates (UAE) accounted for 29 percent. Iran and Venezuela ran the only other significant surpluses; Algeria and Indonesia had the only substantial deficits. Imports into nearly all of the OPEC countries rose at a very rapid pace in calendar year 1975, and, in most cases, imports exceeded 50 percent of the level of the previous year. The estimated distribution of the OPEC current account by country is contained in Table 3.

For OPEC as a whole the volume of imports in calendar year 1975 increased by 43 percent, while import prices, measured in dollars, rose by 7 percent. The annual data, however, obscure the sharp downward trend that has been occurring in the growth rate of OPEC imports since early 1975. By the first quarter of calendar year 1976, import volume was increasing by only 15 percent at an annual rate, as indicated in Table 4.

Since the second quarter of 1975, imports into Algeria, Ecuador, Iran, Nigeria and Venezuela have virtually leveled out. Imports of each of the Arab Gulf countries have continued to increase but since the first quarter of 1975, growth has slackened considerably and physical constraints on further rapid increases in imports into these countries have become a dominant factor in the near term outlook. Industrial country exports to Indonesia, Iraq and Libya have actually declined since mid-1975.

The outlook for calendar year 1976 is for a small increase in the OPEC current account surplus, to $45.7 billion. Import growth is likely to be held to 16.5 percent, while oil revenues are expected to rise by 14 percent, reflecting accelerating global economic activity. The Gulf coun-

TABLE 2.—*OPEC Current Account, 1974–1976*
[$ Million]

	1974	1975	1976*
Exports			
Oil (Gov't Take)	110,400	100,100	114,100
Non-Oil (fob)	6,310	6,135	7,525
Imports (fob)	–38,440	–57,620	–67,120
Trade Balance	78,270	48,615	54,505
Balance on Services & Private Transfers	–6,020	–7,560	–8,780
Freight & Insurance (including demurrage)	–4,640	–7,920	–9,380
Investment Receipts, Net	2,540	6,150	8,900
Other Services & Private Transfers	–3,920	–5,790	–8,300
Current Account Surplus (excluding official transfers)	72,250	41,055	45,725

* Projected.
Source: Treasury Department estimates.

TABLE 3.—*Distribution of OPEC Current Account*
(excluding official transfers)
[$ Millions]

Country	1974	1975	1976*
Algeria	950	–1,990	–1,950
Ecuador	105	–295	–160
Gabon	80	–140	–170
Indonesia	735	–1,180	–635
Iran	12,695	4,320	2,600
Iraq	2,980	1,150	1,640
Kuwait	8,090	7,165	7,040
Libya	2,190	1,345	2,735
Nigeria	5,015	830	1,310
Qatar	1,585	1,225	1,065
Saudi Arabia	26,390	20,140	24,190
UAE	5,620	4,865	6,180
Venezuela	5,815	3,620	1,880
Total—OPEC	72,250	41,055	45,725

* Projected.
Source: Treasury Department estimates.

TABLE 4.—*Increase in Volume of OPEC Imports Over Same Quarter of Previous Year*

	Percent
1975 I	70.2
II	62.8
III	42.8
IV	24.6
1976 I	15.1

tries will continue to account for the bulk of the OPEC surplus with Saudi Arabia's share increasing to about 53 percent and Kuwait and the UAE accounting for an additional 29 percent. Algeria's deficit should remain unchanged, but Indonesia's deficit may be reduced by half.

The most rapid increases in imports in calendar year 1976 are likely to be in the Persian Gulf countries, each of which should record import growth rates in the neighborhood of 25 percent. Algerian and Iraqi imports should grow very slightly, while the increase in imports into Gabon, Libya and Venezuela will be near the group average.

Developments since mid-1975 indicate a pronounced change in the capacity of OPEC countries to absorb additional real resources from abroad. Financial constraints in Algeria and Indonesia have become severe and are almost certain to persist over the next year. The financial positions of Iran, Iraq, Libya and Nigeria are also becoming increasingly tight, although these countries are still running small current account surpluses.

Port problems became especially acute in the Persian Gulf during 1975, although in virtually all of the countries significant progress was made in late 1975 and early 1976 in reducing both the number and the delay of ships waiting to unload. Most of these countries have undertaken major port development projects but significant additional capacity will not become available during the next year. Venezuela, Indonesia, Algeria and Nigeria have adopted policies to limit the growth of imports and these policies are almost certain to continue in some measure, throughout 1976.

These physical and financial constraints suggest that the increase in the volume of imports is not likely to exceed 10 percent in 1976.

International Energy Policies

In his January 1975 State of the Union Message, the President announced the following broad goals for United States energy independence.

(1) In the near term 1975–1977, halt the growing dependence on oil imports;

(2) In the mid-term 1977–1985, achieve invulnerability to supply disruption by a reduction of imports to a manageable level, by the establishment of reserve stocks and by the development of other standby emergency measures; and

(3) In the long term, beyond 1985, mobilize American technology and resources to insure that the United States would be able to contribute to a significant share of the Free World's energy needs.

These goals have remained the cornerstone of the Administration's energy policy and were reaffirmed by the President in his Energy Message of February 26, 1976.

Following the 1973 oil embargo and the subsequent oil price increases, the United States joined with other industrialized consuming nations to develop a framework for international cooperation on energy policy issues. This framework includes, *inter alia,* the May 1974 agreement on an International Energy Program (IEP), and an international program for long-term cooperation in energy to reduce dependence on imported oil. In addition, a Financial Support Fund has been proposed and formal discussions with oil producers under the auspices of the Conference on International Economic Cooperation (CIEC) began in December 1975.

The International Energy Agency was formed in November of 1974 and its membership consists of 19 major industrialized nations. Establishment of the agency was accompanied by signing of an International Energy Program (IEP) agreement which established various coordinating and consultative mechanisms designed to protect against future embargoes and to develop a program of long-term energy cooperation among participating countries. A major element of the IEP agreement is the commitment by oil consuming nations to an emergency program under which members will build emergency oil stocks, cut consumption by a common rate and share available oil in the event of future supply disruptions. This emergency program is now essentially in place.

The IEA has also developed an oil market information system to increase the ability of member governments to help facilitate the harmonization of oil policy. Finally, there are arrangements to monitor the market through mandatory submission of data by international oil companies and governments.

Member countries recently agreed to a program of long-term energy cooperation. The program consists of:

(1.) A framework to facilitate the execution of joint energy projects drawing together capital, technology, and manpower from two or more IEA countries;

(2.) An agreement to help protect investment in domestic energy sources and provide an incentive for the development of new conventional energy through a Minimum Safeguard Price;

(3.) Identification of constraints on increased production from specific energy sectors and formulation of cooperative efforts to remove or reduce these constraints;
(4.) Setting group targets for conservation and energy production and periodic intensive reviews of national energy programs;
(5.) Cooperation in energy research and development in 16 priority areas including concrete joint projects and formulation of a joint overall IEA R&D strategy; and,
(6.) Best endeavors to provide national treatment to other IEA countries in energy.

World Oil Price and Market

During fiscal year 1976, energy costs continued to increase, but not at the rate which had brought the severe adjustment problems of previous years. The hardships to and disruptions of the world economy resulting from the oil price increases of past years have nonetheless continued—recovery from the world recession has been hindered, and structural inflationary pressures have been exacerbated. In particular, the distortion in the pattern of capital investment remains large as resources which would otherwise be utilized to increase world output must be diverted to develop alternatives to high cost OPEC oil, and to replace equipment made obsolete by the relative increases in the price of energy.

The OPEC cartel continued to be the dominant force in the world oil market during fiscal year 1976. In September 1975, OPEC met in Vienna and agreed to increase the price of crude oil by approximately 10 percent. Because of technical adjustments in quality and transportation differentials, however, the increase in the cost of OPEC oil was in reality slightly less than 9 percent on world markets. Prices have not changed significantly since then although possible price increases were discussed at a meeting of OPEC Ministers in May 1976. The issue will be further considered late in 1976.

The escalation of oil prices imposed by OPEC in 1973 and 1974 caused a sharp contraction of the world oil market by the latter half of 1975. For that year as a whole, world crude production fell approximately 5 percent relative to 1974, averaging just over 53 million barrels per day (b/d). Oil production from free world sources fell at an even faster rate, declining by 8 percent to roughly 42 million b/d. In the first 6 months of calendar year 1976, however, free world output showed considerable recovery, increasing 7 percent above first half of calendar 1975 figures. This production advance is being led by Saudi Arabia, whose first half 1976 output ran 20 percent above output levels of a year earlier. OPEC production as a whole has also increased, although it still remains below the record level set in the first half of 1974.

OPEC Oil Revenues and Investment Flows

As discussed earlier in this Chapter, during 1976, OPEC members are expected to accumulate some $45.7 billion in current account surplus, or about $4.7 billion more than in calendar year 1975 but far below the $72 billion surplus recorded in 1974.

OPEC member country investment patterns have shown considerable diversification both in geographic dispersion and in the nature of the investments. Concern that the growing mass of OPEC funds would create placement problems in world money markets has diminished. Private banking institutions, acting either singly or in consortia, have satisfactorily absorbed and placed OPEC investment funds. Fears that possible shifting of such funds, particularly short-term investments, in an unpredictable fashion would create serious disruptions have not been borne out.

During calendar year 1975, the United States received approximately $9.5 billion in investments from OPEC members. This represents just over 23 percent of estimated total investment funds of the oil-producing countries, compared to $11.25 billion in investments (19 percent of total) received by the United States in 1974. Available evidence suggests a significant transition from investments predominantly in short-term bank deposits and Treasury Bills during 1974 to long-term bank deposits and Treasury Bonds and Notes in 1975 and 1976.

Euro-currency markets have also received sizeable OPEC financial flows. Approximately $8 billion was absorbed by these markets in 1975 (down appreciably from $22.5 billion in calendar 1974). Sterling placements in the United Kingdom accounted for only about 0.5 percent of OPEC investments abroad during calendar year 1975, down from 12.5 percent in 1974. Remaining OPEC flows during 1975 were concentrated in the financing of international financial institutions and capital flows (including grants) to the developing countries.

With the exception of a few large investments or investment overtures by individual OPEC members which triggered some concern over national security, public reaction, both domestic and foreign, to OPEC investment patterns and practices has not been substantial. The open, nondiscriminatory capital and securities markets in the United States have adequately handled incoming foreign financial flows from OPEC and other sources. The flexibility and depth these markets have shown in servicing the needs of diverse interests within OPEC is reflected in the increase of OPEC flows to the United States. Further information on OPEC investments in the United States is contained in Chapter VIII of this Annual Report of the National Advisory Council which deals with foreign investment policies and issues.

COMMODITY DEVELOPMENTS

Production, Prices, and Trade

The 1975/76 world agricultural situation was characterized by continued tightness in grain supplies and strong prices which moderated somewhat late in the year by a downward revision in Soviet Union grain import requirements. Vegetable oil supplies increased worldwide compared with the short supplies of the previous year and in the United States the relative price advantage of palm oil was eroded by the large fiscal year 1976 soybean crop and record palm oil imports. In tropical products, a rebound in sugar production dropped world prices to about pre-1974 levels. Early in the year a frost in Brazil sent coffee prices climbing upward largely on the strength of expectations relating to supply availabilities during the next few years. The 1975/76 period also marked an easing in the world fertilizer situation and a break in the relatively high price levels which had prevailed during the past couple of years.

Prospects for a recovery in world grain production were dissipated in early 1975/76 because of drought in the Soviet Union and flooding in portions of Western Europe. Grain prices then rose to peak by early fall due to the consequent expected surge of grain import demand. World grain production excluding rice, in 1975/76 totaled 982 million metric tons, only slightly higher than the disappointing 978 million ton harvest of the previous year. Smaller than expected grain supplies necessitated downward adjustments in grain fed to livestock. Nevertheless, world grain consumption exceeded production in 1975/76 for the second consecutive year leading to a slight increase in the already tight world grain stocks. World grain trade rose to 157 million tons during 1975/76, 12.7 percent more than 1974/75. All of the 17.7 million ton increase in trade was accounted for by a substantial increase of Soviet Union grain imports.

In the United States, the 1975/76 grain crop was up more than a fifth reaching 242 million metric tons. These larger grain supplies accommodated the higher level of exports and enabled some recovery in domestic livestock feeding and grain stocks. However, by the end of 1975/76, though moderated somewhat, grain prices continued to exhibit strength because of the prospects of low end-of-year feed grain stocks and persistent firm demand.

A long-term grain sales agreement between the Soviet Union and the United States was negotiated and scheduled to become effective on October 1, 1976. While preserving the United States open market approach to grain exports, this agreement secures a commitment from the Soviet Union for minimum annual purchases over a five-year period, with a safeguard against disruptive buying and an arrangement on shipping advantageous for the United States.

World sugar production in 1975/76 was estimated at a record 81 million metric tons—up five percent from the 78 million tons produced a year earlier. The rebound in world sugar output following a decline in 1974/75 allowed for an increase in consumption which was estimated at about a half a million tons below production. Despite continued tightness in world sugar stocks (which remain at about 20 percent of consumption) world raw sugar prices on a monthly basis averaged between 13 and 19 cents per pound. In this range, prices were close to levels established in late 1974/75 in anticipation of the record world output and well below the peak average of 57 cents for November 1974.

The Department of Agriculture estimated the 1975/76 world coffee crop at 72 million bags, down eight million bags from the previous year. Early in 1975/76 a frost in Brazil boosted the coffee indicator price of the International Coffee Organization from 60 cents per pound to close to 90 cents. Problems with the Brazilian frost were compounded by an earthquake in Guatemala, war in Angola, and floods in Colombia. These factors combined to keep coffee prices on an upward path through the fiscal year. In late June coffee prices reached $1.50 per pound.

Following the previous year's short supply and high prices. United States production of vegetable oils in fiscal year 1976 increased 15 percent and world production increased 5 percent. These larger supplies precipitated a sharp decline in vegetable oil prices during the first half of fiscal year 1976. Over the latter half of the year both palm and soybean oil prices were steady at a normal historical level, removing the previous relative price advantage enjoyed by palm oil. United States exports of soybean oil increased 24 percent, while imports of palm oil increased by 23 percent.

In 1975/76 fertilizer shortages disappeared and prices fell rapidly, by about 30 percent, to roughly 1973 levels. Inventories in both exporting and importing countries rose, causing many developing countries to reduce fertilizer imports. Fertilizer consumption fell substantially in several major countries, including the United States, France, and India.

Industrial commodity prices were, for the most part, dormant during the early months of 1975/76, but began to rise with renewed economic activity in the middle of the period. Copper, cobalt, and nickel prices were all higher in mid-1976. Chrome prices, which had risen even during the recessionary period, also continued to advance.

Copper prices rose from 52 cents to 73 cents per pound in June 1976. Despite the pick-up in economic activity, world copper stocks stood at a record two million metric tons on June 30, 1976.

Cobalt consumption increased with the economic recovery in the United States in late 1975 and in 1976 consumption returned to its prerecession level. In April 1976, the principal African producers raised their published cobalt price from $4.00 to $4.40 per pound but panic buying in the spring sent actual sale prices up 23 percent over the official price. During this period, the Angolan war disrupted the Benguela rail routes, the shipping artery for Zaire, the leading cobalt producer. The General Services Administration also began restricting its stockpile sales. By August 1976, however, irregular rail shipments from Angola resumed, and the premium on cobalt prices disappeared.

Average monthly nickel consumption in the United States rose from 10,500 short tons during the first half of 1975/76 to approximately 16,000 short tons in the latter half of the period. As a result, imports increased while United States production continued to supply only eight percent of its primary nickel consumption. Producers increased prices 19 cents to $2.20 per pound at mid-year.

Renewed economic activity also prompted a recovery in chrome use by the American steel industry. Prices, which had continued to rise during the recession, advanced about 10 percent from 1974/75 levels. American industry stockpiles remain at the equivalent of one-year's average consumption, but there is some anxiety over the security of supplies because of unsettled conditions in southern Africa.

At the close of the fiscal year, concern was mounting in developed countries that commodity prices would again accelerate in response to the world economic recovery. While there are differing opinions as to the likelihood of a price boom comparable to that of 1973/74, most nations do not view such a price boom as an immediate problem.

International Commodity Policy Developments

The major international commodity developments during 1975/76 related to: a) meetings of the Conference on International Economic Cooperation and its four commissions, b) agreement to expand the IMF Compensatory Finance Facility, c) efforts to renew the coffee, cocoa and tin agreements, and d) approval by the UNC TAD IV Conference in Nairobi in May 1976 of a comprehensive resolution. United States commodity policy has four major objectives: (1) to ensure adequate investment in resource development to meet market demand in the decades ahead; (2) to improve the functioning of individual markets, through case-by-case examinations of individual arrangements; (3) to improve market access for the processed goods of developing countries, while assuring security of supply for consumers; and (4) to promote stable growth for the commodity export earnings of developing countries.

The U.S. "Comprehensive Approach" of the United States, as presented at UNCTAD IV, set forth a number of measures to meet these objectives including improved compensatory financing arrangements; greater information exchange and consultation in producer-consumer forums; agreements for increased supply and market access; promotion of investment in raw materials; research and development to improve market distribution systems and increase production efficiency; and, where buffer stocks are found appropriate, various means for their financing.

The United States does *not* agree, however, with the developing countries' objective of maintaining "real" prices or what amounts to indexation of raw materials prices to the prices of manufactured goods. Indexation would be of primary benefit to developed countries which export commodities, and do great harm to developing countries which are net importers of commodities. Indexation would also introduce artificial rigidities in prices, resulting in misallocation of resources and scarce capital, and underutilization of needed capacity in many parts of the world.

Apart from the disagreement with the developing countries with regard to indexation, the major United States differences with these countries relate to *how* the above objectives are achieved. It is neither United States policy nor intention to supplant market mechanisms or enter into price-fixing or production-limiting commodity agreements.

UNCTAD IV

A major focus for the North-South dialogue on commodity issues in 1975/76 was the Fourth United Nations Conference on Trade and Development (UNCTAD IV) held at Nairobi, Kenya, in May 1976.

The Commodities Resolution adopted at UNCTAD IV sets up two series of international consultations: (1) preparatory meetings on 18 major commodities of interest to developing countries; and (2) preliminary discussions leading to a negotiating conference on a Common Fund no later than March 1977.

The United States will participate in the discussions of individual commodities based on its understanding of the UNCTAD Resolution as stated for the record in Nairobi: namely (1) that these meetings are to determine—without commitment—measures which may be appropriate to these products and (2) that actual negotiations on commodity arrangements will be held as and when required by the results of these meetings. This stress on individual commodity meetings in the Nairobi Resolution is consistent with the United States case-by-case approach to commodities.

The United States opposes the Common Fund for financing buffer stocks as proposed by the UNCTAD Secretariat and supported by the developing countries. The United States believes the proposal is based on two fundamental misconceptions: (1) that higher commodity prices will primarily benefit developing countries; and (2) that lack of financing had been the chief obstacle to the creation of buffer stocks. It is the United States view that high commodity prices will be of greater benefit to developed countries and that the intervention in markets required to achieve stability and higher prices would have a damaging impact on the efficiency of those markets. Also, where buffer stocks are feasible, the obstacles to their creation have not been a lack of financing but rather a lack of agreement by exporters and importers on the price to be defended and the unworkability of buffer stocks for many commodities.

The United States has nevertheless stated its willingness to participate in the preliminary discussions to examine whether further arrangements for financing of buffer stocks including common funding are desirable but has reserved its position on whether or not to participate in the negotiating conference called for by the UNCTAD Resolution.

The Conference narrowly rejected a United States proposal to study the International Resources Bank (IRB). All industrialized nations and seven Latin American countries voted in favor of the resolution. Confusion on the nature of the IRB, opposition by the Socialist bloc, lack of adequate instruction, and reaction by many African states to the refusal by the United States and its allies to endorse the concept of a Common Fund led to defeat of the proposal. Following UNCTAD IV, the United States announced that it would pursue the IRB proposal in other appropriate forums.

The IRB is intended to promote a more rational, efficient global pattern of raw material investment by guaranteeing foreign, primarily private, investment in developing countries against noncommercial risk. Because of certain similarities between its activities and the operations of the World Bank Group, the IRB may be associated with this Group.

Commission on Raw Materials (CIEC)

The first meeting of the Conference on International Economic Cooperation, held in Paris, December 16–19, 1975, initiated an intensified North-South dialogue as described in more detail later in this Chapter. Four Commissions were established to discuss energy, raw materials, development and finance. The Commission on Raw Materials was entrusted with discussing the problems facing markets for raw materials—including food products—and the range of possible solutions to these problems. Discussions in this Commission have covered investment, trade, production, buffer stock arrangements, and compensatory financing for developing countries suffering balance of payments difficulties.

Commodity Agreements

The Fifth International Tin Agreement came into force on July 1, 1976, with the United States a signatory for the first time since the agreement began in 1956. It provides for a buffer stock to buy and sell tin in an effort to keep the price within an agreed range. When commercial and buffer stock purchases are not sufficient to keep prices above the agreed floor, export controls can be put into effect. The votes in the Tin Council are divided equally between producers and consumers.

A new International Coffee Agreement was concluded by over 60 nations in December 1975, and went into effect in October 1976. The United States signed the Agreement on February 26, 1976. Due to the high prices for coffee anticipated for the next two years, the export quota provisions of the Agreement are not expected to come into effect before 1979–80, at the earliest.

In October 1975, negotiations were completed for a new International Cocoa Agreement. The United States did not sign the Agreement due to dissatisfaction with its export quota and price provisions.

Producer Associations

International producer associations during fiscal 1975–76 generally failed to advance their goal of increasing commodity prices for the benefit of the developing countries.

At a meeting in November 1975, the eleven members of the bauxite producer group, the International Bauxite Association (IBA), were not able to approve a minimum pricing policy and instead "recommended" that members adopt minimum price levels. The IBA's inability to influence bauxite prices was due to the slump in aluminum demand in 1975, the slackening of inflationary pressures, and the moderating influence of Australia, the world's largest bauxite producer. Nevertheless, individual bauxite producers continued attempts to increase export earnings, within the loose cooperative framework of the IBA, through export taxes and renegotiation of contracts with aluminum companies.

In June 1976, the Conference of Ministers of the Intergovernmental Council of Copper Exporting Countries (CIPEC) held its first meeting of the year. The conference failed to reach agreement on either continuing, eliminating, or phasing out its 15 percent export and production restriction. As a result, these CIPEC restrictions expired June 30.

In October 1975, the Association of Iron Ore Exporting Countries (AIOEC) was formally inaugurated at a ministerial meeting in London. The association has disclaimed any intention of acting as a cartel. Its purpose, it claims, is to engage in research on iron ore supply and demand problems.

After working on a price stabilization scheme through most of 1975–76, the Association of Natural Rubber Producing Countries (ANRPC) tabled a proposal at the International Rubber Study Group meeting in June 1976. The proposal was a statement of general objectives and principles and did not include a specific description of how the scheme might work. It provides for floor and ceiling prices to be defended through export and production controls and an international buffer stock. Producers will finance the latter, though the ANRPC invites voluntary consumer contributions.

The Union of Banana Exporting Countries (UPEB), whose charter was provisionally approved in 1974, was formally established in Panama on January 23, 1976. However, Ecuador, the world's largest exporter, remains outside the group. A major goal of UPEB is the establishment of an International Banana Agreement with production goals and export quotas.

World Food Conference Follow-up

The World Food Council (WFC) was created to serve as a high-level United Nations entity which would provide political oversight of efforts to implement the comprehensive recommendations of the World Food Conference (see pp. 12–13 of the Fiscal Year 1975 Annual Report of the National Advisory Council). Despite problems associated with the first meeting, the second session of the World Food Council was held in Rome, Italy and successfully focused on the key aspects of the world food problem—food production, food aid and food security. The Council emphasized the importance of increasing food production in the developing countries and welcomed the increase in external resources made available to developing countries to promote their agricultural development. The Council also urged a concerted effort by multilateral and bilateral donors to assist developing countries in identifying and overcoming the constraints on increasing food production.

In fiscal year 1976, food aid to developing countries increased to 9.2 million tons, almost 1 million tons more than the previous year, but short of the global 10 million ton target. It should be noted that the United States alone provided about 6 million tons of food aid in fiscal year 1976. The United States believes that other donors, particularly the newly wealthy countries, should provide their fair share of the global food aid target. There was also considerable concern expressed at the World Food Council on the slow progress in negotiating an international grains reserve which would provide an important element of world food security. The United States delegation called attention to the food grain reserve proposal it had submitted to the International Wheat Council. While recognizing the complex issues involved, the United States delegation urged early agreement on a grains reserve system. This second meeting of the World Food Council took the form of a Preparatory Meeting at the government official level, May 10–14, 1976, and a Council meeting at ministerial level, June 14–16, 1976.

Another forum created at the World Food Conference was the Consultative Group on Food Production and Investment in Developing Countries (CGFPI). The second session of this Group was held in Washington, February 10–12, 1976. The CGFPI further discussed its role and exchanged views on such issues as how to achieve a more rapid increase in food production in developing countries, the amount of external resources made available to developing countries for agriculture, the fertilizer situation and the future program of work.

The proposed $1 billion International Fund for Agricultural Development (IFAD) was an OPEC initiative at the World Food Conference. A Preparatory Commission has been established to bring IFAD into existence. Articles of Agreement will be open for signature when the $1 billion target is reached. For further discussion of IFAD, see Chapter IV of this Report.

International Development Affairs

Relations between the developed and developing nations have attracted much attention in the past few years as a result of a series of dramatic economic and political events. Following a period of confrontation, a "dialogue" has emerged, in large measure as a result of United States initiatives. This dialogue evidences a new willingness on both sides to deal in a serious and cooperative manner with specific measures for stabilizing the international economic system. The United States, for its part, has shown by its active participation in the "North/South dialogue" the great importance it attaches to the efforts at cooperation being undertaken between developed and developing countries.

Throughout the dialogue, the positions of the United States have been determined by our view of development as a long-term process which can most successfully be achieved through effective long-term resource management by developing countries, with the cooperation and assistance of the international community. Governments should play a guiding role in the development process, promoting the free play of market forces and encouraging the full participation of the private sector.

Developing-country views are embodied in what the developing world calls "The New International Economic Order" which includes massive and immediate transfers of funds and technology from developed to developing countries either directly in the form of aid or indirectly through market intervention.

At the Sixth Special Session of the U.N. General Assembly in May 1974, a Declaration and Program of Action on the Establishment of a New International Economic Order (NIEO) were adopted. The Sixth Special Session was seen by the developing countries (in the "Group of 77") as a major breakthrough in focusing world attention on development issues. The resolutions adopted at this session identify basic problem areas in the world economy, from the point of view of the G–77, and outline measures to be taken to alleviate or eliminate the problems.

In December 1974, at the 29th U.N. General Assembly, a Charter of Economic Rights and Duties of States (CERDS) was adopted, also under pressure from the G–77. The Charter makes explicit the notion inherent in the NIEO that the international economy should function so as to give preferential treatment to developing countries.

While being sympathetic with the concerns of the G–77, the developed countries as a group found portions of both the NIEO Declaration and CERDS unacceptable.

The United States supports the legitimate aspirations of the developing countries for economic and social improvement, and fully recognizes that the development of these nations is in everyone's interest. The United States rejects, however, any presumption that this require a "new international economic order." We believe that such a restructuring would be contrary to the long-term interests of the developing countries.

Acting on our belief that solutions to development problems are reached best by strengthening the existing economic system, the United States has advanced a number of initiatives in the North/South dialogue. In addition, we have worked actively to move the discussion of North/South issues from confrontation to dialogue.

While international discussions and negotiations are important in shaping North/South relations, underlying trends in the international economy are equally important. In this connection, the trends of the past year were favorable. As described in greater detail earlier in this chapter, the market economies of the world, led by the United States, began reviving after an economic recession made worse by the sudden and tremendous increase in oil prices after 1973. Industrial production rose in the developed countries; surplus inventories were drawn down; employment and personal incomes increased. As these developments proceeded they were being translated into increased demand for the mineral, agricultural, and manufactured products of the developing nations. With international trade as the medium, the economic upturn in the industrialized countries brought increased income to the developing countries through greater export volume and more buoyant export prices. The developing countries as a whole, however, continued to confront a very large current account deficit.

Forums for the North/South Dialogue

While there were other international forums in which development issues were discussed, four in particular were in the spotlight during fiscal year 1976. First, the U.N. General Assembly held a Seventh Special Session to "accelerate the development of developing countries." Second, a major new forum for discussing North/South relations was created—the Conference on International Economic Cooperation (CIEC). Third, the U.N. Conference on Trade and Development (UNCTAD) held its fourth quadrennial meeting. Fourth, the Joint Ministerial Committee of the Boards of Governors of the IBRD and IMF on the Transfer of Real Resources to Developing Countries (Development Committee) held its fourth and fifth meetings.

U.N. Seventh Special Session: The Seventh Special Session of the U.N. was held in September 1975 in New York City. This session, following up on the Sixth Special Session in May 1974, dealt with North/South relations and gave birth, in effect, to the spirit of dialogue. The Secretary of State made a major address on the opening day of the Seventh Special Session in which he announced a large number of initiatives for improving North/South relations. These included creation of a development security facility to stabilize overall export earnings of developing countries, increased capitalization of the International Finance Corporation, establishment of an International Investment Trust, assistance to developing countries in gaining access to private capital markets, establishment of an International Energy Institute and an international center for the exchange of technological information, a world food grain reserve system, and early implementation of the International Fund for Agricultural Development. The final resolution of the Session contained most of the initiatives of the United States, as well as a number of items on which the United States had reservations.

Conference on International Economic Cooperation (CIEC): The Conference on International Economic Cooperation is the newest forum on North/South issues and consists of representatives from developed countries, non-oil developing countries, and OPEC countries. The CIEC was formally established at a ministerial meeting in Paris in December 1975 with a one-year mandate "to initiate an intensified international dialogue on the international economic situation, to address problems, and to further international economic cooperation for the benefit of all countries and peoples." Due to its restricted participation and generally less formal procedures, the CIEC has proven to be a useful forum for following up and refining ideas first advanced elsewhere, as well as for discussing initiatives presented to the Conference by participants.

There are 27 participants in the CIEC. These include seven industrial countries (Australia, Canada, Japan, Spain, Sweden, Switzerland, and the United States) plus the European Economic Community, and nineteen developing countries (Algeria, Indonesia, Iran, Iraq, Nigeria, Saudi Arabia, Venezuela, Argentina, Brazil, Cameroon, Egypt, India, Jamaica, Mexico, Pakistan, Peru, Yugoslavia, Zaire, and Zambia).

Discussions at the CIEC are taking place simultaneously in four different Commissions: The Energy Commission, the Raw Materials Commission, the Commission on Development, and the Commission on Financial Affairs. Each Commission consists of 15 CIEC members, five from among the industrial-country participants and ten from the developing-country participants. The CIEC has two co-chairmen, and each Commission has two co-chairmen. The Commissions generally have met each month for about one week. The terms of reference for each of the Commissions as agreed upon at the beginning of the Conference are summarized below:

Energy Commission: To carry out a general survey of world prospects for production and consumption of energy, including hydrocarbons, and to facilitate arrangements which seem desirable between oil producers and consumers, and any other energy arrangement.

Raw Materials Commission: To facilitate arrangements which seem desirable in the area of raw materials (including food) that are of particular interest to the LDCs, and to facilitate the establishment of or reinforcement of arrangements emerging from other international forums.

Commission on Development: To facilitate arrangements which seem desirable in the area of cooperation for development, and to facilitate the establishment of or reinforcement of arrangements for accelerating the development of the LDCs emerging from other international forums.

Commission on Financial Affairs: While respecting the jurisdiction of international institutions (IMF, IBRD), to study all financial problems, including their monetary aspects, related to the work of the other three commissions.

The work of the CIEC has been divided into two distinct phases. In the first half of 1976, each Commission concentrated on analysis of the subjects falling within its respective purview. During this stage, the CIEC provided an opportunity for thorough exploration of North/South issues and thereby improved participants' understanding of each others' points of view. The CIEC resumed in September after arduous negotiations that produced a work program that does not prejudge the outcome of the Conference's conclusions. During the second half of the year, the Commissions are discussing elements—recommendations and agreed views—to be contained in reports to a final meeting at the ministerial level which will probably be held in early 1977.

UNCTAD IV: UNCTAD IV began on May 3, 1976. The agenda for this meeting was a lengthy one, with perhaps the major item being the "integrated program for commodities." Other important subjects of discussion at UNCTAD IV were debt relief, transfer of technology, and trade policy.

As in the case of the Seventh Special Session, the Secretary of State made a major address on North/South relations at UNCTAD IV, and announced several positive new initiatives. Some of the more significant of these were: the creation of an International Resources Bank, measures to improve the quality of aid, and numerous initiatives to promote the transfer of technology for the benefit of developing countries.

The Conference made important progress on transfer of technology issues. Three resolutions were adopted by consensus. The United States played a very active role in shaping these resolutions, and many of the initiatives from the Secretary of State's speech were incorporated. Agreement was reached on a work program in the commodities area, although the United States and other industrial nations had numerous reservations about specific aspects of the commodities resolution.

The resolution on debt problems was also the subject of extensive discussion. In the end, a resolution was adopted which called for quick consideration of individual requests for debt relief plus an examination of the features of past debt reschedulings to provide a basis for dealing with individual cases in the future. This resolution was fully acceptable to the United States.

IBRD/IMF Development Committee: As noted in the fiscal year 1975 Annual Report of the Council, the IBRD/IMF Development Committee was established in October 1974 to focus on the broad question of the transfer of real resources to the LDCs. Last year's Annual Report discussed the work of the Development Committee at its first three meetings.

The Fourth meeting of the Development Committee was held in Washington in September 1975. The Committee agreed to ask the Executive Directors of the IMF to continue their work on the Trust Fund and stressed the contribution that the World Bank's Third Window would make toward meeting the capital needs of the developing countries. The Committee also agreed that the Executive Board of the IBRD should give prompt consideration to a selective increase in the capital of the IBRD and received a report from the Working Group on Access to Capital Markets.

At its January 1976 meeting in Kingston, Jamaica, the Development Committee noted the decision of the Interim Committee to establish the Trust Fund to provide concessional balance-of-payments assistance to low-income countries, as well as understandings reached regarding increased access to IMF resources. The Committee received an interim progress report from its Working Group on Access to Capital Markets and urged expanded use of co-financing arrangements by the World Bank and the regional development banks. The Committee also supported an early increase in the capital of the International Finance Corporation and expressed its strong support for a substantially enlarged Fifth Replenishment of the International Development Association.

At its June 1975 meeting, the Development Committee had agreed to establish a Working Group to review regulatory and other constraints affecting LDC access to capital markets, and to continue its study of proposals to support LDC access to private markets, including a possible multilateral guarantee fund. During Fiscal Year 1976, the Working Group met five times to consider issues related to access to capital markets.

The original 1974 parallel resolutions of the World Bank and the International Monetary

Fund establishing the Development Committee provided that at the end of two years, the Boards of Governors of the Bank and the Fund would review the performance of the Committee and take such action as they deemed appropriate. At the joint Bank/Fund annual meeting in Manila in October 1976, the Governors agreed to extend the Committee's mandate unchanged for another two years.

Issues in the North/South Dialogue

Virtually every aspect of international economic relations is under review in the North/South dialogue. During the past year, particular attention has been given to the issues that are reviewed below.

Commodities: For some years, developing countries have been concerned about fluctuations in the prices of their commodity exports and the possibility they are declining over the long term relative to the prices of manufactured imports. Various schemes have been put forward by developing countries to stabilize commodity prices and protect purchasing power. Commodity issues were the central ones in the North/South dialogue during the past year. Three elements in particular were featured: "indexation" of commodity export prices to prices of manufactured imports, the creation of buffer stocks for key commodities, and the establishment of a "common fund" to finance buffer-stock operations. All these elements were included in the "integrated program" on commodities developed by the UNCTAD Secretariat, endorsed at the Manila meeting of the G–77 and reviewed at UNCTAD IV in Nairobi.

The United States responded vigorously on this issue. At the Seventh Special Session, the Secretary of State made several proposals to deal with the problem of commodities in a fashion consistent with our basic principles. Other important initiatives were advanced at UNCTAD IV and in the CIEC.

Another major step during the period under review was the liberalization of the IMF's Compensatory Finance Facility. Further details on developments in the commodities area are provided in Section B of Chapter II.

Trade: In the trade area, developing countries are seeking preferential treatment on a permanent basis in all areas of the Multilateral Trade Negotiations (MTN). They argue that their economic weakness should exempt them from the traditional rules and obligations of the trading system.

Trade issues were debated most intensively during the course of the past year in the Multilateral Trade Negotiations in Geneva. Developing countries expressed concern over the slow pace of these negotiations and attempted to accelerate progress by taking strong positions in the CIEC and at UNCTAD IV.

The United States is willing to examine proposals for special and differential measures where feasible and appropriate, that will allow the developing countries to compete more effectively in world trade. At the same time, we would like to reinforce these countries' commitment to a viable trading system based on at least some degree of reciprocity. We stress that any preferential treatment should be phased out over time as development proceeds.

Further details on our initiatives in the trade area are contained in Chapter V of this Report.

Investment, Multinational Corporations and Transfer of Technology: These three issues all relate to the role of the private sector in promoting development. Developing nations have generally felt themselves to be at a disadvantage in dealing with private investors. Thus, as part of the NIEO, the G–77 has pressed for international action that would place private overseas direct investors more directly under government control and would have serious implications for the current practice of international law as it regards investment. In addition, the G–77 has asked for preferential access to sources of technology. During the past year, all of these issues have been discussed in the Seventh Special Session, the CIEC, and UNCTAD IV.

The basic position of the United States on these issues has been to underscore the benefits for developing countries that can be derived from encouraging the full participation of the private sector in the development process. We have argued that private capital is more productive than official capital and that technology transfer is best accomplished by private enterprise. Nevertheless, the United States is supporting constructive international action on these matters to be responsive to LDC concerns. For example, we are supporting efforts to develop a voluntary code of conduct for multinational corporations. Also, at UNCTAD IV, the United States advanced a substantial number of initiatives in the transfer-of-technology area—notably the establishment of an International Industrialization Institute, the formation of a technology corps, and support for the U.N. Conference on Science and Technology for Development. The United States also indicated support for a voluntary code of conduct for the transfer of technology.

The most far-reaching proposal in this area was our suggestion that an International Resources Bank be established to provide political-risk guarantees for private investors in resources projects in developing countries.

Resource Transfers: The subject of aid flows featured prominently in North/South discussions during the past year. In the language of the final resolution of the U.N. Seventh Special Session, "concessional financial resources to devloping countries need to be increased substantially, their terms and conditions ameliorated, and their flow made predictable, continuous and increasingly assured." Developing countries were particularly anxious to see progress by industrial countries in meeting the target for Official Development Assistance of 0.7 percent of GNP, in increasing the capital resources of the international development banks, and in replenishing the IDA.

The United States has never subscribed to the 0.7 percent target for ODA. Although our performance against this target was 0.26 percent (as compared to the average of 0.36 percent for all DAC donors), the United States continued to be the largest single donor country, with an ODA level in 1975 approximately double that of the second largest donor. Total net flows of official and private resources from the United States to developing countries, reflecting the growth of private capital flows, reached 1.15 percent of GNP in 1975—the first time this figure has exceeded 1 percent for the United States. In addition, during the past year we supported a selective capital increase for the World Bank, proposed a fourfold increase in the capital of the International Finance Corporation, and pledged to join in a substantial fifth replenishment of the International Development Association. Also, the United States was instrumental in establishing a Trust Fund, managed by the IMF as trustee, to provide balance-of-payments support to low-income countries on concessional terms. And Congress authorized a contribution of up to $200 million for the International Fund for Agricultural Development. At the Seventh Special Session of the U.N., the United States proposed the creation of an international investment trust to mobilize portfolio capital for investment in developing-country enterprises. At UNCTAD IV, initiatives of the United States in the area of resource transfers included commitments to reciprocal untying of development assistance and to providing all development assistance to the least-developed countries on a grant basis.

Debt: During the past three years, the current-account deficits of non-oil developing countries soared and, as they turned to private capital markets to finance these deficits, the structure and terms of their outstanding indebtedness hardened. Because debt-service payments grew rapidly and external financing was increasingly allocated for consumption as opposed to investment, many developing countries found that external financing for their development programs was declining. This created pressure for debt relief. Demands for debt relief for developing countries were stated in their most extreme form in the Manila Declaration (February 1976) of the G–77. In this declaration, the G–77 called for the postponement of payments on official debt by any developing country seeking such relief, cancellation of official debt for the least-developed countries, consolidation and rescheduling over 25 years of commercial debts of interested developing countries, and the holding of a conference of debtor and creditor countries in 1976 to work out ways of implementing these measures. Debt relief was the most important item, after the integrated program, discussed at UNCTAD IV, and debt relief was a major issue in the CIEC.

During the past year, the United States steadfastly opposed all forms of generalized debt relief, taking the position that eligibility for relief must be determined on a case-by-case basis by examining each individual country situation. Nevertheless, we did support certain improvements in the Paris Club procedures to be followed in dealing with cases of imminent default. While other industrial countries have expressed varying degrees of willingness to provide debt relief as one form of development aid, the United States has clearly indicated that it cannot use generalized debt relief as a mechanism of development assistance.

Further details on debt negotiations are contained in Chapter VI of this Report.

Law of the Sea: The deep ocean mining negotiations at the Third United Nations Law of the Sea Conference ended in a stalemate. At stake is access to extensive deposits of so-called "manganese nodules", which contain significant quantities of manganese, cobalt, nickel and copper. The principal negotiating impasse concerned the system of access to deep seabed resources. The basic position of the United States has been to ensure that the system provides guaranteed access for private companies and States, after they have satisfied certain objective criteria. The major industrial countries, some of which are currently cooperating with American firms in deep seabed exploration consortia, have supported the concept of assured access. Nevertheless, the G–77 has insisted on giving wide discretionary authority to an International Seabed Authority to regulate all deep seabed operations. The G–77 position is in line with the principles of the "New International Economic Order".

At the last session of the Law of the Sea Conference in September 1976, the United States Government proposed an initiative to reconcile the divergent viewpoints on access to the deep seabed. In return for G–77 agreement to an assured-access system for private firms and States, the United States suggested a scheme that would permit the Enterprise, the operating arm of the International Seabed Authority, to begin its own deep seabed activities in the same time frame as private firms and States. Such a "parallel" system of exploitation could meet the basic requirements of industrial countries for assured access and of developing countries for a share in the exploitation of seabed resources. Although the Conference neither rejected nor accepted the United States initiative, it was widely regarded as a constructive contribution to the negotiations.

The negotiations on deep ocean mining have important implications for overall resource and commodity policy. Underlying the position of the United States in favor of assured access is the desire to encourage an efficient increase in the output of important minerals, and to minimize controls over investment, production and prices.

III. INTERNATIONAL MONETARY AFFAIRS

- Fiscal year 1976 witnessed the culmination of nearly five years of complex negotiations for the reform of the international monetary system.

- The agreements reached by the Interim Committee of the International Monetary Fund at its January 1976 meeting in Jamaica involve a major revision of the international monetary arrangements established at the Bretton Woods Conference in 1944 while preserving the basic objectives of that system of promoting international monetary cooperation and facilitating the international exchange of goods, services and capital.

- Major components of the Jamaica agreements include future provisions on exchange arrangements in the International Monetary Fund (IMF) Articles of Agreement, actions further to reduce the role of gold in the international monetary system, an increase in IMF resources and, steps to increase member country access to these resources, plus other amendments to the IMF Articles of Agreement dealing with its operations and with the Special Drawing Right (SDR).

- The IMF continues to play a central role in meeting world financing requirements stemming from the combined impact of elevated oil prices, inflationary pressures, and recovery from the severe world-wide economic recession. This was reflected in a sharp increase of IMF lending during fiscal year 1976, with currency purchases (drawings) by member countries reaching the record level of SDR 7.6 billion (approximately $8.9 billion equivalent).

- Foreign exchange market performance has improved progressively during the three years of experience under the generalized floating exchange rates system. The United States dollar appreciated over the course of fiscal year 1976 against several major European currencies. On a trade-weighted basis the dollar rose by about 5 percent, almost entirely during the first half of the period, and remained quite steady, on this measurement, during the second half of the fiscal year.

- Gold market prices, as measured by the London fixings, declined fairly steadily during fiscal year 1976, by slightly over $42 per fine troy ounce, to reach $123.80 per fine troy ounce on June 30, 1976.

INTERNATIONAL MONETARY REFORM

During fiscal year 1976 agreement was reached on key elements of a reformed international monetary system. The Jamaica Agreement on international monetary issues represented the culmination of nearly five years of complex negotiations. The substance of these agreements, which involve a major revision of the international monetary arrangements established at the 1944 Bretton Woods Conference, was set forth in a *Special Report* of the National Advisory Council to the Congress transmitted by the Secretary of the Treasury on April 9, 1976.[1] The modifications in the International Monetary

[1] House Document 94-477, "Amendment to the Articles of Agreement and Increase in Quotas of the International Monetary Fund."

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Fund Articles of Agreement worked out over this long negotiating period and the proposed increase in IMF quotas are of major importance to the United States and fulfill critical United States policy objectives. President Ford signed a bill authorizing United States acceptance of these changes [2] on October 20, 1976. The proposed amendments will become effective when three-fifths of IMF members (at least 78 countries) having four-fifths of the total voting power have accepted it. The increase in IMF quotas cannot become effective until the proposed amendments become effective and members having three-fourths of total quotas have consented to the increase in their quotas, and no individual country's quota increase can take effect until the member concerned has notified the IMF of its consent to the increase and has paid its increased quota subscription in full.

Negotiations on Reform of the International Monetary System

In August 1971, as part of a fundamental reorientation of economic policy, the United States suspended the convertibility of foreign official holdings of dollars into gold and imposed a temporary import surcharge. These actions brought foreign acceptance of negotiations to achieve a major multilateral realignment of exchange rate relationships.

Shortly after these August 1971 United States actions, discussions were begun, at the initiative of the United States, on more fundamental reforms of the international monetary system. Formal negotiations began in July 1972 with the establishment of the IMF Committee of Twenty (C–20).[3] From the outset, it was clear that the core issues of the negotiations were to design a system which involved much greater flexibility of exchange rates and firmly promoted action to avoid the huge and destabilizing imbalances that developed late in the Bretton Woods era; to replace gold as the central reserve asset in the system; and to meet desires to avoid reintroduction of what had become, *de facto* at the end of the Bretton Woods era, a dollar-based par value system.

In participating in this reform effort, the United States has stressed several basic principles underlying its positions on these issues:

(1.) The international monetary system should be flexible and adaptable to changing needs and circumstances and facilitate an open, liberal trade and payments system.

(2.) Each nation should retain authority to select its own preferred solutions to correct economic disequilibria within the bounds of responsible international behavior and respecting the rights of other countries.

(3.) The new system should provide a meaningful surveillance authority to oversee its operations.

(4.) A basic objective of the reform efforts must be to restore meaningful stability to the world economy.

The C–20 negotiations made substantial progress toward a consensus on the general outlines of a reformed international monetary system during 1972 and 1973, looking toward a system providing for both adjustable par values and floating exchange rates; effective and symmetrical inducements to balance of payments adjustment on the part of both surplus and deficit countries; and elevation of the Special Drawing Right (SDR) to a position of *numeraire* and central reserve asset of the system in place of gold.

The negotiations were, however, overtaken by the rapid escalation of worldwide inflation, widespread resort to exchange rate floating in early 1973, and by the radical alteration of the world payments structure resulting from sharp increases in oil prices in late 1973 and in 1974. The C–20 decided, in light of the instability then prevailing in the world economy and major uncertainties as to the future, that it would be impractical and undesirable to attempt to agree on, and implement, in the near future a highly structured reform of the international monetary system. At its final meeting in June 1974, the Committee of Twenty made several recommendations designed to establish a framework for the reform process:

(1.) Establishment of a policy level body (the "Interim Committee") in the IMF to oversee the operations and evolution of the international monetary system and to undertake further work on a series of basic amendments to the IMF Articles of Agreement.

(2.) Establishment of a "Development Committee" under joint IMF and International Bank for Reconstruction and Development (IBRD) auspices to consider programs to encourage the transfer

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[2] Public Law 94–564.

[3] This Committee consisted of one member appointed by each country or group of countries appointing or electing an IMF Executive Director.

of real resources to the developing countries.

(3.) Creation of a special IMF Oil Facility.

(4.) Adoption of a new procedure for valuing the SDR in terms of a basket of currencies rather than according to the par value of the dollar.

(5.) Adoption of a set of guidelines for floating exchange rates developed by the C–20.

The Interim Committee, on which the United States is represented by the Secretary of the Treasury, was formally established in October 1974 and immediately commenced intensive negotiations concentrating on two broad subjects: immediate actions needed to confront short-term economic and financial problems, and amendment of the IMF Articles of Agreement with its longer-term implications for the structure of the international monetary system. By August 1975, general agreement had been reached in the Interim Committee on measures to phase gold out of a central role in the monetary system and details of an expansion of IMF quotas were agreed upon. Exchange arrangements remained the key unresolved issue.

Important impetus was given to the Interim Committee's negotiations by the Rambouillet Economic Summit Conference in November 1975, at which broad understandings were reached among the five countries represented both on the provisions relating to exchange arrangements to be included in the amended IMF Articles of Agreement and on more immediate operational issues.

With the Rambouillet understandings on the key remaining issue in the negotiations, in its January 1976 meeting in Jamaica the Interim Committee reached a comprehensive agreement combining long-term structural reforms of the international monetary system with measures to meet current financing needs.

The Jamaica Agreements on International Monetary Issues

The agreements reached by the Interim Committee at Jamaica represent the culmination of nearly five years of negotiations for reform of the international monetary system. The agreements involve a major revision of the international monetary arrangements established at the 1944 Bretton Woods Conference, while preserving the basic objectives of that system. Thus, the broad objectives of promoting international monetary cooperation and facilitating the exchange of goods, services, and capital among countries are reaffirmed, while certain operational aspects of the IMF and of the system are being revised to conform with the evolving needs of the international economy. The reforms of the system agreed upon are designed to promote a smoothly operating monetary structure and to avoid the shocks and disequilibria which arose under the post-war arrangements and which ultimately led to the collapse of the Bretton Woods system.

The final Jamaica package included agreements (some of which had been reached in principle at earlier stages of the negotiations) on future provisions on exchange arrangements in the IMF Articles; actions further to reduce the role of gold in the system, many of which involve amendment of the IMF Articles; other amendments to the IMF Articles dealing with the general operations of that institution and with the Special Drawing Right; an increase in the resources of the IMF; and, a series of measures to increase member country access to IMF resources.

Exchange Arrangements

Central to the negotiations were efforts to develop new exchange rate provisions to replace the obsolete par value arrangements provided for in the original IMF Articles of Agreement. The new exchange rate provisions endorsed by the Interim Committee in January 1976 reflect recognition and agreement that future efforts must focus not on action to peg or manage exchange rates but on achievement of the underlying economic stability which is the prerequisite for exchange rate stability. This constitutes a fundamental reorientation of the Bretton Woods exchange rate provisions. Specifically, the new provisions:

(1.) effectively legalize current exchange rate practices, including floating;

(2.) provide wide latitude for individual countries to adopt specific exchange arrangements of their own choosing, so long as the country fulfills certain obligations regarding, *inter alia,* the promotion of orderly underlying economic conditions and the avoidance of the manipulation of exchange rates in order to prevent effective balance of payments adjustments or gain unfair competitive advantage over other members; and,

(3.) provide a flexible framework for future evolution of the international monetary system.

An important—indeed essential—aspect of the new exchange rate provisions is that the IMF is provided with clear authority to oversee both the international monetary system to ensure its effective operation and the compliance of each member country with its obligations. The IMF will exercise firm surveillance over the exchange rate policies of members and will adopt specific principles for guidance of all members with respect to those policies. Efforts to design a monitoring system and specific guidelines for member countries were actively underway in the IMF at the end of fiscal year 1976.

Gold

Concrete measures will be adopted to phase gold out of a central role in the international monetary system:

(1.) The official price of gold will be abolished, and gold will lose its formal position as *numerarie* of the system—as the common denominator for the par value system, as the unit of account for the Special Drawing Right, and as the standard of value for all rights and obligations *vis-a-vis* the IMF. While gold has already ceased to perform these functions in practice, formal recognition of these changes is basic to the international demonetization of gold.

(2.) Gold will be eliminated as an important instrument in IMF transactions, in contrast to its central position in virtually all transactions authorized under the current IMF Articles. All requirements for use of gold in transactions between the IMF and member countries—for example, in quota subscriptions, payment of charges, and replenishment operations—will be terminated. In addition, the IMF will be prohibited from accepting gold, unless there is a specific decision to the contrary by an eighty-five percent majority vote. Existing requirements for use of gold in transactions with the IMF are to be replaced with requirements to use SDRs or, if so decided by the IMF, currencies.

(3.) In addition to these measures it was agreed to begin disposal, under existing authority, of 50 million ounces of gold held by the IMF (about one-third of its total holdings), 25 million ounces to be sold for the benefit of developing countries and 25 million ounces to be sold to IMF members in proportion to quotas.

Furthermore, in order to assure that, in the process of dismantling the various rules and restraints on official transactions in gold that exist in the present IMF Articles, gold does not re-emerge as an important monetary instrument, the Group of Ten—the major gold holding nations—have agreed to the following arrangements, which came into force beginning February 1, 1976:

(1.) That there be no action to peg the price of gold.

(2.) That the total stock of gold now in the hands of the IMF and of the monetary authorities of the Group of Ten will not be increased.

(3.) That each party to these arrangements will report semi-annually to the IMF and to the Bank for International Settlements the total amount of gold that has been bought or sold.

(4.) That the parties to these arrangements agree to respect any further conditions governing gold trading which may be agreed to by their Central Bank representatives.

(5.) That each party agree these arrangements will be reviewed by the participants at the end of two years and then continued, modified, or terminated. Any party to these arrangements may terminate its adherence to them after the initial two-year period. Other nations may adhere to these arrangements (Switzerland and Portugal have also agreed to do so) and on such occasions any necessary modifications in the arrangements would be made.

Other Amendments to IMF Articles of Agreement

In addition to the amendments dealing with exchange rates and gold, a number of other amendments are being introduced to improve the quality and extend the usability of the Special Drawing Right (SDR) and to effect a variety of important organizational and operational changes in the IMF.

Special Drawing Rights (SDRs). IMF provisions dealing with the SDR have been modified to improve the quality and usability of this reserve asset. These changes are designed to move the SDR closer to becoming the principal reserve asset of the international monetary system. Three basic changes are contemplated. First, members will be free to enter into SDR transactions between one another on a voluntary basis without the necessity of special IMF authorization and without proving the need to exchange reserve assets in order to provide for specific balance of payments financing requirements. The specific need requirement and necessity for prior special IMF authorization for all SDR transactions are currently in effect. Second, the possible uses of SDRs will be expanded and the IMF may broaden the categories of holders, although not beyond official entities, and the operations in which they may engage. Third, decisions to alter certain policies governing SDRs—such as rules for reconstitution, and terms and conditions governing approved transactions—will require reduced majorities.

IMF Organization and Operation. In order to provide for continuing supervision of the management and adaptation of the international monetary system, the amended IMF Articles of Agreement include a provision which will permit the IMF Board of Governors, by an eighty-five percent majority vote, to create a new body within the IMF—the IMF Council. This entity would replace the present Interim Committee in composition and in terms of reference but would differ from the Interim Committee in that it would have powers of decision, not just advisory authority. The IMF amendments also include a provision affirming the present size and composition of the IMF Board of Executive Directors: a twenty-member Board consisting of five Executive Directors appointed by the five members with the largest quotas (currently the United States, the United Kingdom, Germany, France, and Japan) and of fifteen members elected by groupings, or constituencies, of member countries. The proposed Articles require that any changes in the number of Executive Directors would require an eighty-five percent majority vote.

A wide variety of operational changes will be implemented as part of the IMF amendments. The most important of these are:

(1.) Provisions ensuring that IMF holdings of member currencies will be usable by the IMF in its operations and transactions. This agreement will add substantially to the IMF's available resources and, thus, enable it to continue to be the major official source of balance of payments assistance for its members.

(2.) Provisions allowing borrowing under IMF special financing facilities (those established to assist with particular balance of payments problems) to be made without reducing any reserve position in the IMF the borrower may have.

(3.) Provisions giving the IMF broad authority to establish policies on repurchase (i.e., repayment of borrowings from the IMF) appropriate to the needs of the international monetary system.

(4.) Provisions reorganizing the General Account, renaming it the General Department. The new General Department will include several accounts, corresponding to an orderly division of the IMF's diverse financial transactions.

(5.) Provisions establishing an Investment Account and giving the IMF explicit authority to invest currencies, not in excess of the IMF's earned reserves, in income-producing, marketable obligations of international financial organizations or of the members whose currencies are used for the investment.

IMF Quotas

Quotas in the IMF are to be expanded by approximately SDR 10 billion (33.6 percent), to SDR 39 billion. A slight reduction in the United States voting share in the IMF to just under 20 percent as a consequence of the quota increases will be accompanied by an increase from eighty to eighty-five percent of the majority required to effect decisions of major policy significance in the IMF. All IMF member countries have agreed in connection with increases in their quotas to accept an unambiguous legal obligation to allow the IMF to use their currency subscriptions in its lending operations—which is not now the case.

Expansion of Access to IMF Resources

The Jamaica agreements included three measures to expand the ability of the IMF to provide balance of payments financing to its members. All of these proposals have become effective:

(1.) Prompt creation of a Trust Fund, separate from, but managed by, the IMF as trustee, designed to provide needed balance of payments financing to the poorest IMF member countries on highly concessional terms and to be financed by IMF gold sales.

(2.) Pending implementation of the proposed amendment, a temporary 45 percent expansion of members' potential access to regular IMF resources in order to assist members in meeting exceptional balance of payments financing needs.

(3.) Liberalization of the IMF Compensatory Financing Facility, which provides primary-producing countries with additional access to IMF resources to meet external financing difficulties arising from temporary shortfalls in export earnings due primarily to factors beyond the member's control.

Additional details on these three measures are included in the next section of this Chapter dealing with the operations of the International Monetary Fund.

INTERNATIONAL MONETARY FUND OPERATIONS

The International Monetary Fund is the principal official multilateral source of balance of payments financing. During fiscal year 1976 the IMF continued to play a central role in meeting the world's financing needs arising from the combined impact of high oil prices, inflationary pressures, and recovery from the severe global economic recession. This was reflected in a sharp increase of IMF lending during fiscal year 1976, with purchases of currency (drawings) by IMF members reaching a record SDR 7.6 billion (about \$8.9 billion)[4]. This included substantial growth in drawings under the IMF's regular resources as well as in operations of the IMF's special financing facilities—the Compensatory Financing Facility, the Extended Fund Facility, and the Oil Facility.

Regular IMF Resources

Purchases under the IMF's regular resources during fiscal year 1976 amounted to SDR 2,218 million by 27 countries. The United Kingdom was the single largest borrower, with drawings of SDR 1,400 million, followed by South Africa (SDR 171 million) and Indonesia (SDR 80 million). Principal currencies drawn from the IMF were the United States dollar, the French franc, the German mark, and the Japanese yen. The use of United States dollars in IMF drawings increased substantially over levels recorded in recent years. Special Drawing Rights were drawn from the IMF in the amount of SDR 448 million.

Repayments of previous drawings (repurchases) totalled SDR 630 million in fiscal year 1976. Currencies used in repurchases included Deutsche marks (SDR 70 million), United States dollars (SDR 48 million), Japanese yen (SDR 22 million) and French francs (SDR 13 million). Repurchases with Special Drawing Rights amounted to SDR 425 million.

As of June 30, 1976, cumulative drawings from the beginning of IMF operations had amounted to SDR 30,755 million, of which SDR 9,606 million were in United States dollars; cumulative repurchases had amounted to SDR 17,807 million, of which SDR 4,773 million were in United States dollars. These figures apply to the use of IMF regular resources only.

The United States' reserve position in the IMF increased to SDR 2,790 million during fiscal 1976 as a result of purchases of United States dollars by other countries amounting to SDR 925 million.

As a temporary measure pending implementation of the quota increase, members' potential access to regular IMF credit resources was raised by 45 percent in January 1976 as a means of assisting them to meet the exceptional financing demands associated with the current world economic situation.

There was no activation during fiscal year 1976 of the General Arrangements to Borrow (GAB). These arrangements, established in 1962 by ten industrial countries including the United States, are an integral part of the IMF designed to supplement the IMF's resources, if needed, to cope with developments which threaten to impair the operations of the international monetary system. GAB commitments, which totalled approximately SDR 5,500 million at the end of fiscal year 1976, were most recently renewed on October 23, 1974, for a period of five years. The United States' share in the GAB is \$2,000 million.

Compensatory Financing and Buffer Stock Arrangements

The IMF has established two commodity-related special financing facilities—the Compensatory Financing Facility and the Buffer Stock Facility. The Compensatory Financing Facility, established in 1963 and liberalized in 1966 and in December 1975, provides primary-producing countries with additional access to IMF resources to meet balance of payments difficulties arising from temporary shortfalls in export earnings due primarily to circumstances beyond their control. A country with an overall balance of payments need may draw up to 50 percent of its quota under this Facility to finance an export shortfall in any twelve-month period, and may have outstanding purchases from the Facility amounting to a total of 75 percent of quota.

In order to be eligible to draw from the Compensatory Financing Facility, a member must be

[4] Conversions from SDRs to dollars in this section of the Report are made at the rate of \$1.17 equals SDR 1. This is the fiscal year 1976 monthly average dollar/SDR exchange rate. The value of the SDR in terms of currencies fluctuates daily in response to changes in market exchange rates.

experiencing a shortfall in export earnings that is of a short-term nature and is substantially beyond its control; have an overall balance of payments need; and, agree to cooperate with the IMF in finding appropriate solutions to its balance of payments difficulties.

Following a recommendation of the Interim Committee, the IMF liberalized the Compensatory Financing Facility in December 1975 so as to increase member country access. The liberalization provided for:

(1.) Elimination of an existing limit of 10 percent on forecasted annual export growth in the post-shortfall period.

(2.) Raising of quota limits on Compensatory Financing from 25 percent of quota in any 12-month period and 50 percent of total outstanding to 50 percent and 75 percent, respectively. In addition, the 75 percent of quota limit on Compensatory and Buffer Stock drawings was eliminated.

(3.) Requests based on shortfall periods for which export data are estimated for up to six months.

(4.) Modifications of the rules relating to reclassification of ordinary drawings into Compensatory purchases to permit reclassification to be made within 18 months, instead of 6 months, from the date of the ordinary drawing.

The December 1975 liberalization of the Compensatory Financing Facility was strongly supported by the United States.

The amount of export shortfall eligible for compensation is calculated as the difference between exports in the shortfall year and the average annual level of exports in a five-year period that is centered on the shortfall year (i.e., taking into account export forecasts for the two succeeding years), subject to the quota limits noted above. Drawings from the Facility are subject to the same interest rate and repayments provision as are drawings from regular IMF resources—i.e., 4 to 6 percent annual interest rate and 3 to 5 year maturities. Borrowings from the Compensatory Financing Facility do not reduce a country's access to regular drawings from the IMF.

During the 13 years since the Compensatory Financing Facility was established, 47 countries have made 89 drawings. At the end of fiscal 1976, these drawings totalled, cumulatively, SDR 2,177 million. Of this amount, drawings outstanding at the close of fiscal 1976 amounted to SDR 1,482 million. Following the 1975 liberalization of access to this Facility purchases have increased rapidly. Drawings in fiscal 1976 alone amounted to SDR 1,177 million. The 1975 liberalization has proved a particularly important means of assisting primary-producing developing countries overcome some of the economic problems ensuing from sharp fluctuations in world market prices for their exports of primary products.

The second IMF commodity financing arrangement—the Buffer Stock Facility—was created in 1969 to help members having balance of payments needs finance their contributions to international buffer stocks which satisfy specified IMF criteria. Drawings from the Buffer Stock Facility carry the same interest rate and repayment provisions as regular IMF drawings except that disbursement of funds from an international buffer stock to a member must be used to repay drawings from the Buffer Stock Facility.

Loans from this Facility are subject to the condition that a member borrowing from the Facility must cooperate with the IMF to find appropriate solutions to its balance of payments difficulties. Countries may draw up to 50 percent of quota under the Facility. As noted, the 1975 liberalization of the Compensatory Financing Facility eliminated the 75 percent quota limit on combined Compensatory and Buffer Stock drawings.

Under the terms of the Buffer Stock Facility, an international buffer stock could be eligible for IMF financing if it met criteria designed:

(1.) to ensure that all IMF members, whether or not they participate in the buffer stock, are treated equitably by the buffer stock arrangement, and in particular, that consumers as well as producers participating in the arrangement are able to have an effective voice in decisions on its operations;

(2.) to provide that the buffer stock pricing policies contribute to earnings stabilization, that stock accumulations and sales balance out over the medium-term, that excessive use is not made of quantitative controls, and that funds from the IMF are used only for financing related to acquisition of stock; and,

(3.) to prevent long-term restriction of supply as a means of artificially maintaining prices above a long-term trend.

Two international buffer stocks—tin and cocoa—were declared eligible (in 1970 and in 1973, respectively) under IMF criteria for financial support from this Facility, although funds have been drawn down only for the tin buffer stock. Total drawings have amounted to SDR 30 million (about $35 million) by five countries. SDR 5 million in drawings were outstanding at the end of fiscal year 1976.

The IMF amendments currently under consideration by member governments include a provision which will permit Buffer Stock Facility drawings without reducing a country's access to regular IMF resources.

Trust Fund and Gold Auctions

On May 5, 1976, the IMF established a Trust Fund designed to provide balance of payments assistance on concessionary terms to 61 low-income developing country members. The origins and early development of the concept of the Trust Fund, originally proposed by the United States, were discussed in considerable detail in last year's Annual Report of the National Advisory Council.

The Trust Fund and IMF sales of gold meet two major objectives of the United States in the international financial area:

(1.) Reduction in the international monetary role of gold.

(2.) Mobilization of resources to meet urgent balance of payments financing needs of the poorest developing countries in the current period of exceptional payments imbalance.

The Trust Fund, which is legally separate from, but managed by, the IMF as trustee, will be financed from profits on the sale of IMF gold. Periodic sales of a total of 25 million ounces of gold at public auction will be held over the four-year period beginning June 2, 1976. Sixteen auctions of 780,000 ounces each will be held over the first two years, at approximately six-week intervals. (As of the beginning of fiscal year 1977 there had been three such gold sales. The gold thus auctioned brought an average price of $119.15 per ounce, yielding a total profit for the Trust Fund of $184 million.)

Only the poorest IMF developing country members are eligible for support from the Trust Fund. A balance of payments need and an economic program tailored to improve the country's balance of payments position are required. Trust Fund loans will carry a ten-year repayment term, including a grace period of five years, and a one-half of one percent interest rate. Initial disbursements on loans under the Trust Fund are expected to occur during calendar year 1977. The Trust Fund will also make "direct transfer" to developing countries of part of the profits on the gold sales in proportion to their share of IMF quotas on August 13, 1975.

Extended Fund Facility

The Extended Fund Facility, established on September 13, 1974, is designed to provide balance of payments assistance to IMF members in support of comprehensive programs of structural economic adjustment. In order to draw from the Extended Fund Facility the member country must prepare and adhere to a comprehensive multi-year program of structural reform approved by the IMF. Credits may be provided over a three-year period, subject to adherence to the agreed program, in contrast to the normal one-year limit of regular IMF resources. Drawings from this Facility have longer repayment periods (4 to 8 years) than drawings from regular IMF resources and bear a slightly higher interest rate in the later years. A country may draw up to 140 percent of its quota under this program but not in excess of 165 percent of its quota from both this source and from regular IMF resources combined (the joint limit was temporarily raised to 176 percent of quota by the temporary expansion of access to the IMF's regular resources).

At the end of fiscal year 1976, assistance from the Extended Fund Facility had been approved for two countries—Kenya and the Philippines—for SDR 67 million and SDR 217 million, respectively. In August 1975 Kenya drew SDR 8 million under its arrangement.

IMF Oil Facility

The IMF Oil Facility was a temporary program designed to respond to emergency needs arising from sharply increased oil prices. New lending from this Facility was terminated on March 31, 1976. Drawings from the Facility were made by 55 countries and totalled the equivalent of SDR 6,902 million during its less than two years of operation.

The resources which were available under the Oil Facility were derived from IMF borrowings from the oil producing countries and from a number of developed countries. Access had been separated from access to regular IMF resources and rates of interest paid and charged were substantially higher than for regular IMF resources. During the life of the Facility, a total of SDR 6,902 million was lent to it, to be repaid over a period of 4 to 7 years. Small amounts have been already repaid.

On August 1, 1975, the IMF established a subsidy account under a trust arrangement separate from the Oil Facility to assist those less developed IMF country members most seriously affected by the increased price of petroleum by reducing the effective rate of annual interest to be paid by these countries on their borrowings from the 1975 Oil Facility. The account will be financed by voluntary national contributions which are expected to total about SDR 160 million and to make possible a subsidy of about 5 percentage points for eligible borrowers from the Oil Facility. Subsidy payments from the account will be made over the 1976 to 1983 period. The first round of subsidy payments to 18 IMF members was disbursed in July 1976 and totalled SDR 14 million.

LEGISLATION ON INTERNATIONAL MONETARY AFFAIRS

The Jamaica Agreements

The IMF amendments and quota increase legislation was approved by the House of Representatives on July 27, 1976, by a large majority. The United States Senate passed similar legislation on October 1, 1976, just prior to adjournment and President Ford signed the legislation [5] on October 20, 1976.

Financial Support Fund

The Financial Support Fund is designed as a temporary mechanism—a "safety net"—to encourage cooperation in energy and economic policy by supplementing other sources of financing in the event participating OECD members cannot obtain elsewhere, on reasonable terms, the financing needed to avoid recourse to restrictive trade policies, capital controls, or undue restraints on domestic economic activity.[6] Proposed legislation authorizing United States participation in the Financial Support Fund was submitted to the Congress on June 6, 1975. Early in fiscal year 1976 hearings on the Financial Support Fund were held by the Senate Foreign Relations Committee and by the Subcommittee on International Trade, Investment, and Monetary Policy of the House Banking Committee. Secretary Simon and other Treasury officials testified several times later in fiscal year 1976 emphasizing the need for establishing this Fund. Secretary Simon testified again before the Senate Foreign Relations Committee in support of the Fund on March 26, 1976, and in April 1976, the Senate Foreign Relations Committee favorably reported out authorization legislation. On June 4, 1976, Secretary Simon testified again in support of the Fund before the Senate Committee on Banking, Housing, and Urban Affairs reemphasizing the urgent need for United States' participation in this Fund. At the close of fiscal year 1976 United States participation in the Financial Support Fund was still under Congressional consideration.

Foreign Exchange Market Developments and Operations

The performance of the foreign exchange market has improved progressively during the three years of experience under the system of generalized floating rates which evolved following the breakdown of the par value system. As in previous years, there were periods during which exchange rate movements for particular currencies were large, but there was increased recognition in the market that rate movements reflected underlying economic and financial conditions in the world economy, and the foreign exchange markets have functioned in a way that has facilitated the flow of international trade and payments. At the Rambouillet economic summit meeting in November 1975, agreement was reached to intensify consultations among Finance Ministers and central banks on underlying economic conditions, to work towards greater economic stability, and to act to counter disorderly conditions in the foreign exchange market. The understandings reached at the meeting also formed the basis for subsequent agreement on the provisions relating to exchange arrangements to be incorporated in amendments to the IMF Articles of Agreement, and thus set the stage for agreement by the IMF Interim Committee in January 1976 on a comprehensive revision of the IMF Articles of Agreement.

Movements in exchange rates for the U.S. dollar in terms of the major foreign currencies were mixed over the period under review. As noted in other sections in this report, high rates of inflation persisted in all countries, but wide differences in inflation rates and economic performance among countries also persisted, which may explain much of the diversity in exchange rate movements during the period. Relative to the group of currencies patricipating in the European common margins "snake" arrangement, the dollar rose by more than 10 percent in value during the first half of fiscal year 1976, following a comparable decline during fiscal year 1975, and was little changed in the second half. The dollar's value increased by large amounts relative to the Italian lira and the pound sterling (by 33 per-

[5] Public Law 94-564.

[6] A full description of the origins and major provisions of the Financial Support Fund is contained in the May 1975 *Special Report* of the National Advisory Council to the Congress (House Document 94-178).

cent and 23 percent, respectively) with most movement occurring after the first half of the fiscal year. The dollar also rose somewhat against the French franc, particularly after that currency's departure from the EC snake in mid-March 1976. The dollar declined slightly in value relative to the Canadian dollar, the Japanese yen and the Swiss franc. On a trade-weighted average basis, the dollar appreciated by about 5%, almost entirely during the first half of the fiscal year. On this measurement it remained quite steady over the second half, with the appreciation against some currencies, principally the pound sterling and the Italian lira, offset by a depreciation relative to others, notably the Canadian dollar.

The appreciation of the dollar early in the fiscal year reflected the effects of reversal of a number of developments which had been a factor in its depreciation in terms of several major foreign currencies during the preceding several months. U.S. interest rates rose relative to those in other major centers; economic recovery in the United States proceeded in advance of that in most other industrial countries; the U.S. merchandise trade position increased; and the United States appeared to be gaining control over inflation.

Foreign exchange market operations by the Federal Reserve during this period were undertaken primarily to purchase foreign currencies, chiefly German marks, needed to repay outstanding swap indebtedness with foreign central banks incurred earlier in 1975 and in late 1974. Such swap debts had reached a peak in excess of the equivalent of $1 billion. Among the major foreign authorities, the Japanese, German and Italian authorities sold dollars in the market to provide support for their respective currencies, while the Swiss authorities purchased dollars to curb appreciation of the Swiss franc. The French authorities, after countering some speculative pressure prior to the French franc's reentry into the EC snake arrangement on July 10, purchased dollars as their currency appreciated in terms of the German mark and other EC snake participants.

In October 1975, easing of interest rates on dollar-denominated deposits, concern over the possibility of a New York City default, and release of economic indicators suggesting that the recovery of the U.S. economy might be slowing, influenced the market. During a brief period of dollar selling in the markets, the dollar depreciated against nearly all major foreign currencies. The Federal Reserve purchased a small amount of dollars, against German marks, to counter market disorder, reversing these transactions during ensuing weeks. In November and December, market conditions improved and, while the U.S. economic recovery slowed, it remained well in advance of that in the rest of the world. Substantial demand for Swiss francs, continued and the Swiss authorities intervened to curb further appreciation of the Swiss franc. As earlier, the French authorities also made large dollar purchases. The Italian and the Japanese authorities continued to sell dollars to counter pressure on their currencies. Throughout the latter part of calendar 1975, the pound sterling was steady in terms of the dollar, and the Bank of England gained dollars from market operations.

In the second half of the fiscal year, movements in the values of major foreign currencies in terms of the dollar were more a reflection of developments in individual foreign countries than of events in the United States. In general, these movements were indicative of the ability of the system to respond to changes in underlying economic circumstances. To help counter disorderly conditions in the markets for sterling and Italian lire, U.S. authorities provided short-term swap assistance to the Bank of England and to the Bank of Italy.

Early in calendar 1976, the Italian lira depreciated, at times sharply, following the resignation of the Government. After a sizable depletion of its foreign exchange reserves through intervention in support of the lira over a period of several months, the Bank of Italy withdrew from the market beginning January 21, allowing the lira, floating freely, to depreciate further. Following the formation of a new Government in February, the Bank of Italy reentered the market at the beginning of March. Capital flight from Italy continued, however, and the Bank of Italy drew a total of $500 million on its swap line with the Federal Reserve during the quarter. The British pound depreciated abruptly in early March, and the 2¼% exchange rate margins of the EC snake currencies came under significant pressure. The markets anticipated further movements in currency exchange rates to reflect divergent price and external account performances and outlook among the major industrial countries, and substantial intervention in both dollars and European currencies was undertaken by participating countries to maintain the EC snake margins. The German central bank purchased very large amounts of foreign exchange, particularly the currencies of other EC snake participants. On March 15, the French franc abandoned the EC snake arrangements and depreciated by about 4 percent. In addition, the Belgian and Dutch authorities suspended their narrower 1½% Benelux exchange rate margins. The Bank of

England also intervened on a large scale, selling dollars in the market to curb the depreciation of sterling. Although the dollar was not itself the major focus of attention, exchange market conditions became unsettled from time to time, and the Federal Reserve periodically sold German marks to counter disorderly trading conditions. The yen had begun to appreciate in December, after depreciating throughout most of 1975.

After the Italian lira reached a low point in early May, the Italian authorities applied a temporary 50%, 90-day deposit requirement on virtually all purchases of foreign currencies and introduced other measures designed to limit speculation against the lira. Sterling continued to experience strong selling pressure and, early in June, short-term standby lines of credit totaling $5.3 billion were made available to the Bank of England by major industrial countries, including $1 billion each by the U.S. Treasury Exchange Stabilization Fund and the Federal Reserve System. By the end of the fiscal year, the British had drawn slightly more than $1 billion against these credit lines, including $200 million each from the U.S. Treasury and Federal Reserve.

Following departure of the French franc from the EC snake arrangement, the currency band was maintained although the Netherlands guilder and Belgian franc experienced renewed selling pressure periodically and depreciated toward their lower limits against the German mark. The Swiss franc continued to experience substantial demand and reached record levels against both the German mark and the dollar. In response, the Swiss authorities indicated that they were prepared to intervene massively and further tightened restrictions on franc transactions. The Canadian dollar also appreciated probably reflecting both high Canadian interest rates, particularly relative to U.S. rates, and large external borrowing.

Strong selling pressure on sterling developed in the third quarter of 1976. The British authorities responded by raising interest rates, increasing the minimum lending rate to a record 13 percent. Trading in EC snake currencies during the transition quarter was dominated by widespread expectations that the German mark would be revalued relative to the other participating currencies. Federal Reserve intervention during the third quarter was limited to sales of $25 million equivalent of DM at times when trading became unsettled, purchases of about the same amount of DM at other times, and purchases of Belgian francs to reduce its outstanding swap debt to the Belgian National Bank. Selling pressures on the French franc intensified early in the third quarter, but the franc subsequently appreciated. Bank of Italy intervention gains early in the quarter permitted repayment in full of the $500 million drawing on the Federal Reserve swap line earlier in the year. But selling pressure on the lira reemerged, as funds placed with the Bank of Italy in May under the three-month deposit requirement began to be withdrawn and with the passing of seasonally large demand for lire. Germany's gold collateral loan to Italy was extended, with the Italian authorities repaying $500 million of the $2 billion outstanding. The Japanese yen appreciated by 5 percent during the quarter. Following heavy trading in Canadian dollars during late June and early July, the market calmed and the Canadian dollar declined somewhat.

Gold market prices, as measured by the London fixings, declined during the fiscal year, by $42.45 per fine troy ounce to $123.80 on June 30, 1976. Following the U.S. Treasury auction of 500,000 ounces at $165.05 on June 30, 1975, gold traded in the $163–165 range in July and August. In September 1975 the price declined to an average of $144 and traded close to that level through December 1975. In January 1976 the price moved down to an average of $132 and traded fairly narrowly around that level through March before gradually drifting to the $126 level in June.

UNITED STATES BALANCE OF PAYMENTS DEVELOPMENTS

The principal development in the United States balance of payments during fiscal year 1976 was a sharp swing in the merchandise trade balance, from an annual rate of roughly $9 billion surplus in the July-December 1975 half of the year to a $6 billion annual rate deficit in the January-June 1976 half year. Because of its timing, this shift is best examined on a half year, rather than the full fiscal year, basis. (See Table 5).

The major factor behind this surplus-to-deficit swing on net merchandise trade was the strong recovery of import demand in the United States by the third (January-March) quarter of fiscal year 1976, to more or less cyclically-normal levels —following an extraordinary slump, during the second (January-June) half of fiscal year 1975, associated with general recession and massive inventory adjustments in the United States domestic economy. Between the July-December 1974 and the January-June halves of 1975 there was a roughly $10 billion annual-rate slowdown in

TABLE 5.—*United States Merchandise Trade, July 1974–June 1976*

[In $ billion, rounded]

	Half-Year Totals			
	July–Dec. 1974	Jan–June 1975	July–Dec. 1975	Jan–June 1976
Exports (+)	51.6	52.9	54.2	55.3
Agriculture	10.9	10.9	11.3	11.2
Other	40.8	41.9	42.9	44.1
Imports (–)	–55.4	–48.1	–49.9	–58.2
Fuels	–15.2	–13.6	–14.9	–17.1
Other	–40.2	–34.5	–35.0	–41.2
TRADE BALANCE	– 3.7	4.7	4.3	– 3.0
(Balance *excluding* agricultural exports and fuel imports)	(0.6)	(7.4)	(7.9)	(2.9)

Note: Half-year data, due to seasonal adjustment on a calendar-year basis, will not add precisely to fiscal-year totals. Data on balance of payments basis.

Source: Department of Commerce.

American non-fuel imports, which was completely reversed again between the first and second halves of fiscal year 1976.

A second important factor contributing to this change on total trade account was a combined cyclical and trend increase in the volume of petroleum imports, due to rising consumption plus declining domestic production, compounded by rising oil-import prices. The recession-period decline in United States total fuel imports was both briefer and smaller than for other imports; and the net increase in such fuel imports between the first half of fiscal year 1975 and the second half of fiscal year 1976 was roughly $4 billion on an annual-rate basis.

Agricultural exports held steady at roughly a $22 billion annual rate, through both fiscal years 1975 and 1976.

The United States trade balance, excluding agricultural exports and fuel imports, has shifted over this period (all amounts on annual-rate basis) from (a) a roughly $1 billion surplus in the July-December 1974 half of fiscal year 1975 to (b) recession-related temporary surpluses of roughly $15 billion in both of the two following half years, to (c) a continuing, but much smaller, surplus of almost $6 billion in the January-June half of fiscal year 1976.

TABLE 6.—*Summary of the International Transactions of the United States*

[$ billions, seasonally adjusted]

	1975				1976	
	I	II	III	IV	I	II
Exports of Goods and Services	36.9	35.8	37.0	38.6	38.6	40.2
Imports of Goods and Services	–34.3	–30.7	–32.8	–34.2	–37.5	–38.7
U.S. Government Grants (excluding military)	– 0.7	– 0.7	– 0.6	– 0.8	– 0.6	– 0.4
Remittances and Other Transfers	– 0.0	– 0.4	– 0.4	– 0.4	– 0.4	– 0.4
U.S. Assets Abroad (net)[1]	– 8.0	– 7.9	– 4.4	–11.2	–10.0	– 8.8
Foreign Assets in U.S. (net)[2]	2.8	3.9	2.7	5.9	5.4	7.2
Statistical Discrepancy	3.7	....	– 1.5	2.2	4.7	0.9

NOTES:

[1] Increase/Capital Outflow (–).

[2] Increase/Capital Inflow (+).

Detail may not add to total due to rounding.

Source: Department of Commerce.

IV. MULTILATERAL ECONOMIC DEVELOPMENT ASSISTANCE

- During fiscal year 1976 and the Transition Quarter Congress appropriated $696 million as the United States' fiscal year 1976 contribution and $745 million as the United States' fiscal year 1977 contribution to the resources of the international development lending institutions (IDLIs). In fiscal year 1975 the United States had contributed $619 million to the resources of these institutions.

- Legislation authorizing the United States to contribute $2.25 billion to a replenishment of the resources of the Inter-American Development Bank (IDB) and $25 million to join the African Development Fund (AFDF) was also approved by Congress during the fiscal year.

- The World Bank Group—the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC)—committed $6,877 million in loans, credits, and investments during fiscal year 1976, an increase of 11 percent over fiscal year 1975 levels.

- The Inter-American Development Bank authorized loans totaling $1,231 million, a 16 percent increase over the fiscal year 1975 level.

- The Asian Development Bank (ADB) committed $883 million to its borrowing member countries during fiscal year 1976, a 55 percent increase over fiscal year 1975.

- In fiscal year 1976 the World Bank instituted a new lending rate formula under which the Bank's lending rate will change automatically with its cost of borrowing. The new lending rate guarantees the IBRD will fully cover all of its borrowing, administrative and liquidity costs. The IDB also instituted an automatic lending rate formula during the fiscal year and the ADB held discussions looking toward establishment of such a formula sometime in fiscal year 1977.

- The Board of Directors of the IBRD approved an $8.4 billion selective capital increase and the IFC Board of Directors approved a $540 million replenishment of its resources.

- The Board of Directors of the Asian Development Bank approved a $4.96 billion replenishment of the capital of that Bank. An $809 million replenishment of the Bank's soft loan window, the Asian Development Fund (ADF), was also approved by the ADB Board of Governors during fiscal year 1976.

MULTILATERAL DEVELOPMENT FINANCE POLICY OBJECTIVES

The United States supports the efforts of the international development lending institutions (IDLIs)[1] as a means for worldwide cooperation in promoting economic and social development. The United States believes a program of multilateral economic development assistance, in conjunction with traditional bilateral programs, achieves maximum effectiveness in providing assistance to developing countries. The United States has worked with the IDLIs over the years to insure that their basic approaches and priorities are consistent with sound development policies, with particular emphasis on increasing the economic efficiency of all development efforts.

To this end, the United States has supported IDLI efforts to expand and strengthen the role of market forces as the most effective means of allocating resources, strengthening the role of private enterprise, and promoting the creation of developing country economies with trade and investment policies compatible with the economies of the industrialized countries. The active participation of the United States in the development experience of the less developed countries (LDCs) through a multilateral economic assistance program provides an opportunity to cooperate with these countries in dealing with trade, finance, energy and resource problems of pressing importance to the increasingly interdependent world community.

During recent years, the United States has led and encouraged the IDLIs to place greater emphasis on lending in sectors that most directly benefit the neediest people in the LDCs such as agriculture, irrigation, health, nutrition, housing and education. In order to make more funds available to the poorest countries the United States supports the phasing out of concessional assistance to all but the poorest countries and the graduation of higher income countries from borrower status. The United States is also working to improve its review of IDLI evaluation of lending programs and project implementation with a view to improving the cost-effectiveness of all IDLI project loans.

Other major United States objectives in the IDLIs include:

- making the IDLIs financially stronger so that eventually they will be able to obtain all their funds on international capital markets, thus obviating the need for further infusions of paid-in capital;
- stretching IDLI loanable resources, primarily by increased use of co-financing between the IDLIs and private lenders;
- reducing the United States share of financing in the IDLIs.

[1] These are the World Bank Group (comprising the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC), the Inter-American Development Bank (IDB), and the Asian Development Bank (ADB).

UNITED STATES LEGISLATIVE CONSIDERATION AND IDLI RESOURCE AVAILABILITIES

Authorizing Legislation

In fiscal year 1976, Congress approved legislation authorizing increased United States participation in the Inter-American Development Bank and United States membership in the African Development Fund. A bill authorizing an additional contribution to the Asian Development Fund was approved by the Senate but was not voted on by the House of Representatives. The Administration also proposed legislation during fiscal year 1976 which would authorize increased United States participation in the IBRD, the International Finance Corporation and the International Development Association, and the Ordinary Capital of the Asian Development Bank. These proposals were not considered by the 94th Congress and will be resubmitted for consideration by the 95th Congress.

Inter-American Development Bank and African Development Fund

In May 1976 the Congress authorized the United States Governor of the Inter-American Development Bank to vote in favor of a major replenishment of that Bank's capital and its Fund for Special Operations (FSO). The United States share of the capital increase was set at $1,650 million, of which $120 million is in the form of paid-in capital and the remaining $1,530 million in the form of callable capital. The authorized contribution to the FSO is $600 million. This legislation also authorized the United States Governor to vote in favor of changes in the IDB's charter to permit entry of non-regional countries as members of the Bank.

This same legislation also authorized the United States to become a member of the African Development Fund (AFDF) with an initial contribution of $25 million. The United States joined the AFDF in November 1976.

Asian Development Fund

In fiscal year 1976, the ADB Board of Governors adopted a resolution providing for an $809 million replenishment of the Bank's soft loan affiliate, the Asian Development Fund (ADF). The United States share was determined to be $180 million, and an authorization of $50 million was requested from the Congress for the first installment of our share. The Senate approved this amount in May 1976 but the measure was not brought to a vote in the House of Representatives.

World Bank Group

In May 1976 the Administration sent to the Congress a request for authorization for United States participation in a selective increase of the IBRD's capital. The proposed United States share of the increase is $1,570 million of which $157 million would be paid-in. Authorization to increase the United States commitment to the International Finance Corporation by $111.4 million was also requested. A third bill pertaining to the International Development Association of the World Bank Group was also submitted to the Congress. This bill would authorize the United States Governor of the International Development Association to agree to contribute to IDA such unspecified sums as may be necessary for the United States contribution to the Fifth Replenishment of the Association's resources. Finally, a request for authorization of such sums as may be necessary for the United States to participate in a capital replenishment of the Asian Development Bank was submitted The 94th Congress did not consider any of these measures, however, and similar requests will be resubmitted in January 1977 for consideration by the 95th Congress.

Appropriations Legislation

The Congress appropriated $695.6 million for United States participation in the IDLIs for fiscal year 1976 and $745.5 million for fiscal year 1977. The figure for fiscal year 1976 included appropriations of $320 million for the first installment of the Fourth Replenishment of the International Development Association, $225 million for the IDB Fund for Special Operations, $120.6 million for the capital of the Asian Development Bank, $25 million for the ADB soft loan window (the Asian Development Fund), and $5 million for the African Development Fund (the soft loan window of the African Development Bank).

Appropriations approved for fiscal year 1977 included $375 million for the second installment of the Fourth Replenishment of IDA (IDA IV), $20 million paid-in inter-regional capital and $200 million callable Ordinary Capital for the IDB, $50 million for the Fund for Special Operations, $90.45 million for the Ordinary Capital of the ADB and $10 million for the AFDF.

The amounts appropriated for fiscal year 1976 were $380 million less than the totals requested by the Administration. Funds requested, but not appropriated, included $55 million for the first U.S. contribution to IDA IV, $50 million for the FSO of the IDB, $40 million in paid-in inter-regional capital and $200 million in callable Ordinary Capital of the IDB requested under the recently authorized IDB replenishment, $25 million for the Asian Development Fund and $10 million for the African Development Fund. During congressional hearings on IDLI appropriations, Executive Branch witnesses indicated that the Administration planned to request Congress to appropriate, in fiscal year 1977, any amounts cut from fiscal year 1976 submissions, in addition to the normal fiscal year 1977 requirements.

Amounts requested, but not appropriated, in the initial fiscal year 1977 budget included $20 million of paid-in inter-regional capital of the IDB, $200 million for the Fund for Special Operations, $30.15 million of callable capital for the ADB and $25 million for the Asian Development Fund. Congress did not consider the Administration's request that shortfalls from fiscal year 1976 be appropriated in fiscal year 1977. The Administration expects to submit a supplemental budget during fiscal year 1977 to provide for the shortfalls from the fiscal years 1976 and 1977 appropriations requests.

Shortfalls in the expected levels of contributions from the United States have resulted in some problems for the IDLIs. Some lending programs may have to be reduced and development planning has become more tenuous. This also makes it more difficult to convince other member countries to support the development policies proposed by the United States.

DEVELOPMENT LENDING BY THE IDLIs DURING FISCAL YEAR 1976

Recapitulation

The World Bank and its affiliates (the International Development Association and the International Finance Corporation), the Inter-

American Development Bank, and the Asian Development Bank made loans totaling $8,992 million during fiscal year 1976. This is more than one-sixth of total cumulative IDLI lending and represents an increase of almost 14 percent over the fiscal year 1975 levels, when the IDLIs lent a total of $7,743 million.

Lending in fiscal year 1976 was concentrated in the agricultural sector which accounted for 24 percent of the total and reflected the continuing concern for this sector during the last several years. The next most important sector was transportation and communications, which received 21 percent. The power sector received 14 percent of IDLI funds during fiscal year 1976 and development finance companies received 11 percent.

The number and scope of agricultural projects financed in recent years reflects the growing concern of the IDLIs to improve agricultural productivity and output through both traditional methods and new approaches such as rural development projects which, for example, combine into one project all of the productive inputs and infrastructure necessary to increase agricultural output.

The World Bank Group approved loans totaling $6,878 million during fiscal year 1976. The IBRD increased its level of lending by more than 15 percent, from $4,320 million in fiscal year 1975 to $4,977 million in fiscal year 1976; IDA increased its level of lending by 5 percent, from $1,576 million to $1,655 million. In percentage terms, ADB lending registered the largest increase, growing by 55 percent. Ordinary Capital lending almost doubled, from $375 million to $669 million, while Special Funds lending increased from $194 million to $214 million. The IDB's lending program increased by 16 percent in fiscal year 1976. The Fund for Special Operations accounted for all of the increase, rising from $475 million to $645 million; Ordinary Capital lending declined by $4 million (to $586 million), as the Bank's lending program was severely constrained by a shortage of funds, pending capital replenishment.

Table 7 summarizes IDLI lending during fiscal year 1976 by institution and by sector of lending.

WORLD BANK GROUP

Lending Program

The World Bank Group (IBRD, IDA, and IFC) committed $6,878 million for economic development assistance to its member countries during fiscal year 1976, a 12 percent increase over the fiscal year 1975 level. The IBRD made new loans of $4,977 million, up 15 percent over the preceding fiscal year. New IDA credits rose by 5.0 percent, to $1,655 million. IFC commitments increased by almost 16 percent, to $245 million.

As of June 30, 1976, total IBRD loans outstanding [2] amounted to $26,091 million and total

[2] Total loans outstanding are the disbursed and undisbursed portions of effective loans held by the IBRD plus loans approved but not yet effective. The total is net of repayments, sales, participations and cancellations.

TABLE 7.—*IDLI Development Lending Fiscal Year 1976*

[Millions of dollars]

	World Bank			IDB		ADB			
	IBRD	IDA	IFC	OC	FSO	OC	ADF	Total	Percent
Agriculture	1,209.2	418.4		164.8	118.4	128.0	134.0	2,172.8	24
Preinvestment					5.2			5.2	.....
Dev. Fin. Co.	697.1	64.0	44.1			212.0		1,017.2	11
Education	244.9	76.4		20.0	56.7	14.5		412.5	5
Industry/Mining	501.0	105.0	200.3	105.0	18.1			929.4	10
Non-Project	75.0	354.0						429.0	5
Population	25.8							25.8	.....
Power	690.3	259.0		230.3	108.7			1,288.3	14
Tourism	21.0	10.0	0.9	20.0	4.9			56.8	.....
Trans./Comm.	1,173.7	261.4		22.1	219.6	154.6	10.0	1,841.4	21
Urbanization	79.6				25.2			104.8	1
Water Supply	246.5	88.1		22.9	88.6	159.8	70.0	675.9	8
Export Financing				0.5				0.5	.....
Tech. Assistance	13.0	19.0						32.0	.....
Total	4,977.1	1,655.3	245.3	585.6	645.4	668.9	214.0	8,992.3	100

Source: IBRD–International Bank for Reconstruction and Development, IDA–International Development Association, IFC–International Finance Corporation, IDB–Inter-American Development Bank, and the ADB–Asian Development Bank.

IDA credits outstanding topped $10,000 million for the first time, reaching $10,424 million. IFC cumulative gross commitments reached $1,507 million.

IBRD and IDA lending is increasingly concentrated in agricultural and rural development projects. For the second consecutive year, lending for agriculture and rural development was larger than for any other sector. Because of the large number of agricultural and rural development projects approved during the previous year and the amount of lead time necessary to prepare such projects, agricultural loans, as a percentage of total commitments, declined from 32 percent in 1975 to 27 percent in fiscal year 1976. (In 1974, the figure was 22 percent).

The IBRD and IDA committed funds for 214 development projects in 74 countries during the fiscal year, distributed by region as follows: Africa $891 million; Asia $2,801 million; Latin America $1,448 million; Europe, the Middle East and North Africa, $1,486 million. India was the largest individual borrower from the IBRD and IDA ($894 million), while Indonesia was second, ($517 million) and Brazil third ($498 million).

IFC commitments during fiscal year 1976 went to 33 enterprises in 23 developing countries, plus one regional project. These commitments included four projects in Europe, (36 percent of the total amount committed), 10 projects in Asia (29 percent), nine projects in Latin America (18 percent), 8 projects in Africa (13 percent), and 1 in the Middle East (3 percent). Yugoslavia received the largest individual total ($50 million), with the Republic of Korea second ($47.8 million), and Turkey third ($38.5 million).

U.S. Initiatives

At the September 1975 Annual Meeting of the World Bank in Washington the Secretary of the Treasury set forth a range of proposals as part of the United States program to assist the developing countries. As a matter of high priority, the Secretary proposed creation of a development security facility in the IMF to prevent excessive fluctuations in export earnings from disrupting growth. The Secretary also pledged United States support for a major expansion of the capital of the International Finance Corporation, the only member of the World Bank Group designed exclusively to promote private investment. Finally, the Secretary of the Treasury stressed the appropriateness of a substantial increase in the World Bank's capital and an increase in voting power for countries newly able to make greater contributions to development through the World Bank Group. Considerable progress has been made on each of these initiatives since September 1975, especially with regard to the capital increases of the IBRD and the IFC.

To ensure continued effectiveness in these efforts, the spokesman for the United States also stressed the importance of sound financial policies for the Bank Group. During the fiscal year, progress was made in achieving this objective. The first step in strengthening the Bank's financial structure was an agreement to slow down the rate of growth in the Bank's annual lending program. The second was the development of a lending rate formula which fully covers the cost of funds to the Bank in world financial markets as well as its administrative and liquidity costs. At the end of the fiscal year, the Bank's interest rate was raised in two steps from 8.5 percent to 8.9 percent.

IBRD Resources

Funds for IBRD operations are derived from: paid-in capital subscriptions; borrowings in private capital markets, and from governments and central banks; sales of participations; principal repayments on loans; and, earnings on its loans and investments.

As in the past, borrowings provided the major portion of the Bank's funds in fiscal year 1976 when the volume of IBRD gross borrowings reached a record level, with 41 issues totaling $3,811 million. This was $301 million (8 percent) more than in the preceding fiscal year. During the five fiscal years 1972 to 1976, gross borrowings by the Bank aggregated $12,641 million, an amount equal to 2.6 times the volume of its borrowing during the preceding five-year period.

The main source of borrowed funds for the Bank shifted substantially in fiscal year 1976. In the preceding three years, governments and central banks had been the major sources, supplying 59 percent of total borrowed funds in fiscal year 1973, 80 percent in 1974, and 76 percent in 1975. In fiscal year 1976, however, governments and central banks supplied $1,351 million, or 35 percent of the Bank's borrowed funds, while private markets supplied $2,331 million, or 61 percent of the total. In addition, $126 million, or 3 percent of total borrowings during the fiscal year, was borrowed by the Bank from the Interest Subsidy Fund, which was established during the fiscal year to permit concessional lending from the Third Window of the IBRD. This was a new and temporary source of funds for the Bank.

During the fiscal year under review, the Bank's public and private borrowings came principally from the following sources: $1,275 million in the United States; $700 million from the issuance of two-year dollar bonds to central banks and other government agencies in some 65 other countries; $666 million in Germany; $445 million from members of OPEC, (of which Kuwait accounted for $155 million); $288 million in Switzerland; $189 million in Japan; and $167 million in the Netherlands.

The Bank's funded debt outstanding increased $2,360 million during the fiscal year, to $14,647 million as of June 30, 1976. As of that date, estimates indicate that 25 percent of the Bank's obligations were held by investors in the United States, 21 percent in Germany, 10 percent in Japan, 8 percent in Saudi Arabia, and 7 percent in Switzerland. The remaining 29 percent of the Bank's outstanding borrowings was held by investment institutions, including central banks and government agencies, in more than 80 other countries.

During the fiscal year borrowers repaid $677 million to the Bank, raising cumulative repayments on Bank loans to $7,241 million; of this $4,949 million was paid to the Bank and $2,292 million to purchasers of the loans. Income on Bank investments increased by $42 million to $425 million for the year, while income on loans increased $131 million, or 14 percent, to $897 million. Sales of participations in the Bank's loan portfolio amounted to $30 million—twice the amount of participations sold in the preceding fiscal year.

Net income of the Bank in fiscal year 1976 was $213 million, decline of 20 percent from the previous year's level. As a result of currency adjustments (which resulted in a $151 million loss to the Bank during the period) the Bank's income available for allocation to reserves or for other purposes was reduced to $69 million. In October 1976, the Bank's Board of Governors approved a transfer of $100 million as a grant to IDA. Since this amount exceeded the $69 million available from income, $31 million was taken from the Bank's general reserve. The United States recommended limiting the amount of the transfer to IDA to $69 million, which would have avoided a reduction in reserves, but was outvoted.

Gross borrowings by the Bank during fiscal year 1976 were larger than its disbursement level of $2,600 million. As a result, Bank liquidity rose by $1,226 million, to a total of $6,395 million, or slightly less than 50 percent of the Bank's estimated net borrowing requirements of $13,100 million over the next three years.

IDA

IDA provides concessional lending to support projects in the poorest of the developing countries which cannot afford to borrow at the near-commercial rates which apply to standard IBRD loans. IDA projects must, however, meet the same rigorous standards that apply to other Bank loans. Currently, some 92 percent of all IDA credit commitments are to 66 countries with per capita incomes of less than $200, almost entirely in Asia and Africa where most of the lowest income countries are located. Approximately half of these commitments were for agricultural and transportation projects, with the other half widely scattered among other economic sectors.

In fiscal year 1976, IDA granted new credits totaling $1,655 million, an increase of $79 million over the previous year. Total IDA credits outstanding exceeded the $10 billion mark during the fiscal year. Funding during the fiscal year came principally from member countries' contributions, which constituted 93 percent of the Association's resources. Other funds were derived from the aforementioned grants out of the IBRD's net income (6.2%) and repayments of credits (.7%).

Due to the delay and reduction of IDA IV appropriations, the United States has been unable to agree to a specific total size or on respective shares for a fifth replenishment of IDA (IDA V). As a result, the negotiations have been delayed and IDA V will not begin on July 1, 1977, as had been originally envisaged. IDA and its member countries became concerned over the slow progress in the replenishment negotiations during fiscal year 1976 as well as over United States payments for the IDA IV shortfall.

IFC

The Administration considers the future expansion of the IFC to be an important element for promoting economic growth in the developing world. This support reflects a long-term commitment by the United States to private enterprise. The development process necessarily involves a cooperative effort between the public and private sectors, both domestic and foreign. The needs for investment are too great, and resources too scarce, for the developing countries to depend exclusively on either publc or private investment. A blending of the two is essential. In many cases, the private sector has proven its effectiveness in seeking out the most profitable investment opportunities and in effectively using locally available resources.

Of the World Bank family, only the IFC is specifically designed to encourage the growth of the private sector in developing countries. For every dollar of capital it supplies, the IFC generates four dollars from private lenders. Essentially, the IFC operates like a private investment bank by bringing together opportunities, domestic and foreign private capital, and experienced management. In the 1970s, the IFC and its private associates accounted for about 7 percent of the flow of non-petroleum investment (net of reinvested earnings) from the OECD countries to developing countries.

In fiscal year 1976, the IFC invested $245.3 million in 33 investments in loans and equity, in 23 different developing countries. This was an increase of 15.8 percent over fiscal year 1975. IFC's quasi-governmental and private sector partners contributed $1,505 million to joint projects, compared with $1,096 million in 1975. IFC's operations in fiscal year 1976 brought the cumulative gross total of its loans and equity investments to $1,507 million in 271 enterprises since its establishment in 1956.

Expansion of the IFC: Future growth of the IFC will soon be restrained by its limited capital base and the limitations imposed on borrowings by its charter. The IFC charter prohibits a total debt which exceeds four times its unimpaired subscribed capital and surplus when it is in debt to the IBRD. Thus, the IFC needs to expand its capital base in order to continue borrowing from the IBRD, which is its principal source of funds. It also needs a capital expansion in order to continue its unique equity investments.

The United States has taken the lead in supporting a major expansion of the IFC's capital through public statements made by the Secretary of the Treasury at the Annual Meeting of the IBRD/IMF in September 1975, and by the Secretary of State at the United Nations Seventh Special Session earlier in the same month. Agreement was reached at meetings of IFC's principal shareholders in Paris in November 1975 and in New York in January 1976 on the general principles and amounts of capital to be raised. In May 1976 the IFC Board of Directors approved the capital increase and the proposal is presently being considered by the Governors of the IFC.

Under the proposed replenishment, the authorized capital of the IFC would be increased by $540 million, to $650 million, which, to be effective, must be approved by three-quarters of the total weighted vote of IFC members by December 31, 1976 (unless this deadline is extended). The United States share of the replenishment would be $111.4 million. The formula used for determining member subscriptions is based on relative shares in the World Bank following the proposed selective capital increase.

Of the proposed United States subscription, $44.6 million would be appropriated in fiscal year 1978 and $33.4 million each in fiscal years 1979 and 1980. The proposal would result in a substantial reduction—from 33 percent to 25 percent—in the share of the United States in the capital of the IFC—a reduction consistent with our policy on burden-sharing.

Major Policy Issues and Developments

IBRD Selective Capital Increase: In conjunction with the recent agreement on an increase in IMF quotas, the Executive Directors of the IBRD recommended (in May 1976) that the Bank be authorized to increase its capitalization by $8.4 billion from its 127 member countries. This increase in capitalization will provide the means for the Bank to continue its pivotal long-term role of channeling funds to the developing countries.

In order to participate in this capital increase, the United States requires congressional authorizaton and for this purpose the Secretary of the Treasury forwarded a legislative proposal to the Congress in May 1976. The 94th Congress took no action on this legislation, however, and the Administration will resubmit it to the first session of the 95th Congress. Under the proposal, the United States would subscribe to 13,005 shares of capital at a cost of $1,568.9 million. Of this amount, 10 percent would be paid in and 90 percent would be in the form of callable capital. The United States share would represent approximately 19 percent of the proposed total increase and, as a result, our voting power in the IBRD would decline—from 22.6 percent to 21.9 percent —a shift consistent with the United States policy of burden sharing.

The IBRD capital increase is an important element in our foreign assistance policy. The United States considers the Bank to be an indispensable source of capital for the developing countries, and a means of promoting productive long-term investment. The proposed increase would allow the Bank to maintain its current level of commitments into the 1980s.

The deliberations on the selective capital increase provided an opportunity for increased attention to the relationship between the lending program of the Bank and its underlying financial structure. In its efforts to meet the development needs of the poorer countries, the Bank had expanded its annual level of commitments from $2 billion in fiscal year 1972 to $5 billion in fiscal year 1976. This growth led the Board of Directors to consider how best to accommodate the growing demands on the Bank with the importance of preserving a sound financial structure.

Automatic Lending Rate Formula

The IBRD Board of Directors, in approving the selective capital increase, sought to insure this accommodation through two collateral decisions. First, agreement was reached that, pending consideration of a future general capital increase, increases in the Bank's lending program would be continued within an upper limit on the level of annual lending ($5.8 billion) which could be sustained on the basis of the Bank's present capital, as supplemented by the selective increase. Second, the Bank adopted a new formula for determining its lending rate. Recognizing the need to make periodic adjustments in its lending rate to reflect changes in its borrowing costs, the Bank now reviews its lending rate at the end of each quarter and adjusts it to the average weighted cost of Bank borrowing during the preceding twelve months. To this is added a positive spread of one-half of one percent to cover administrative and liquidity costs. (The initial use of this formula, in May 1976, resulted in a change in the Bank's lending rate from 8.5 percent to 8.85 percent effective June 1, 1976. This was later changed to 8.9 percent effective July 1, 1976.)

Previously, there had been a lag in the Bank's response to changes in its borrowing costs. While this was not a significant problem in periods when the interest rate trend was generally stable, during periods of rising interest rates the impact of delayed lending rate changes would be to subsidize the actual lending rate from the income derived from paid-in capital and reserves. Thus, the periodic, prompt adjustment in the Bank's lending rate has avoided the risk of gradual decapitalization and increasing vulnerability to risk.

The United States played a leading role in the Board's deliberations on these issues and fully supports these decisions designed to strengthen the financial structure of the Bank.

The Third Window: During fiscal year 1976, an additional form of financing by the World Bank Group became available with the opening of the temporary Subsidy Fund or "Third Window", which extends loans on terms intermediate between the standard IBRD rate and the highly concessional IDA rate. By the end of the fiscal year, total voluntary contributions to the Subsidy Fund had amounted to $124.9 million. These contributions will permit the Bank to make over $600 million of Third Window loans during the two fiscal years of its operation (1976–1977). Total lending on Third Window terms was $477.8 million during fiscal year 1976 and the Bank expects to subsidize an additional $140 million of such lending in fiscal year 1977.

The Subsidy Fund supplements interest payments due to the Bank from borrowers by paying the Bank an amount equal to 4 percent per year of the outstanding principal of loans made on Third Window terms. The borrowers pay only the difference between the 4 percent and the current IBRD lending rate. Two types of borrowers may apply for Third Window assistance: countries experiencing cyclical or secular economic difficulties, and countries that have recently "graduated" from borrowing from IDA. Before obtaining intermediate financing through the Third Window, both types of borrowers must demonstrate inability to borrow more conventional IBRD funds.

The United States has not participated in the Third Window, believing it to be unnecessary since blending of loans from the IBRD and IDA can accomplish the same objective.

OPEC Transition from Borrower to Lender

Members of OPEC have shifted from net borrowers to net lenders of capital to the World Bank Group during the fiscal year. The number of loans made to OPEC members has decreased from 23 in fiscal year 1974 to 19 in fiscal year 1975, to 16 in fiscal year 1976. During fiscal year 1976 only four of the thirteen OPEC members borrowed from the IBRD and none borrowed from IDA.

Members of OPEC have provided development capital to the Bank through four principal devices. First, a significant amount of co-financing has come from oil exporting countries. During the past two years, OPEC countries provided co-financing of nearly $1 billion to complement Bank resources in 30 projects in 16 countries. Second, oil exporting countries have been major purchasers of IBRD securities—during fiscal year 1976 they purchased $445 million worth of obligations, or 12% of total issues floated. Third, oil exporting countries propose to provide 21.1% of the IBRD's capital increase. The largest subscriptions will be made by Saudi Arabia ($453 million), Iran ($453 million), Venezuela ($218 million), Nigeria ($215 million), Kuwait ($206 million), and Indonesia ($204 million). Fourth, members of OPEC were instrumental in establishing the Subsidy Fund or Third Window, as a part of the World Bank Group and OPEC members have contributed $62 million, or 50% of the total Fund. In the longer term, members of OPEC propose to contribute a significant proportion—perhaps 10 percent—of the IDA V replenishment currently under discussion. The United States hopes these countries with steady incomes from oil exports will continue to expand their programs of multilateral aid to assist the non-oil producing developing countries.

Socialist Republic of Vietnam (SRV) Membership in the World Bank: Despite a United States vote in opposition, the IBRD Executive Directors voted, on September 21, 1976, to regard the Socialist Republic of Vietnam (SRV) as the government representing Vietnam in the Bank. The week before, a similar vote had been held by the IMF Board of Executive Directors where the United States also cast a negative vote.

The United States Government position regarding SRV membership in these institutions is that the decision regarding membership is premature. United States representatives at the Bank and the IMF took the position that we remain uncertain about the SRV's willingness to carry out fully its international obligations, and that we do not have sufficient information to enable us to determine whether the SRV would be in a position to carry out its obligations to these institutions.

INTER-AMERICAN DEVELOPMENT BANK

Lending Program

During fiscal year 1976 the IDB committed a total of $1,231 million, a 16 percent increase in lending over fiscal year 1975. Of this amount, $586 million was lent on conventional terms from Ordinary Capital (OC) resources and $645 million was lent on concessionary terms from the Fund for Special Operations (FSO). In addition, the IDB committed $129.5 million in funds it administers for various donors (primarily the Venezuelan Trust Fund). Cumulative lending by the IDB, as of June 30, 1976, totalled $9.0 billion, of which $4.1 billion had been lent from Ordinary Capital, $4.2 billion from the Fund for Special Operations, and $0.7 billion from other resources (primarily the United States Social Progress Trust Fund).

The power and agricultural sectors received the greatest attention in fiscal year 1976. About 28 percent ($339 million) of the funds committed was for power and 23 percent ($283 million) for agricultural development. On a cumulative basis through the end of fiscal year 1976, agriculture had received the largest amount, 23 percent or $2.1 billion, and power projects had received the next largest amount, 21 percent or $1.9 billion. (In some cases, distribution of IDLI loans into sectors tends to be arbitrary because many of these projects have multi-purpose aspects, such as dams which benefit rural areas through irrigation as well as through electric power generation).

The IDB lending program for calendar year 1976 (the Bank's fiscal year) continued to emphasize lending to the poorest countries of the region. IDB management reiterated its intention of maintaining an increase in total lending at an annual rate of 7 percent in real terms. The United States Executive Director expressed concern as to the projected 11 percent direct increase in lending during calendar year 1976 over the previous year in view of the prospective shortage of Ordinary Capital and FSO resources expected to prevail until the 1970 and 1976 replenishments are completed and funds are made available.

Resources

IDB lending operations are financed principally from paid-in capital subscriptions, borrowings in international capital markets, and member country contributions to the FSO. At the end of fiscal year 1976, the total subscribed capital of the Bank was $6,248 million, of which $983 million was paid-in and $5,265 million was callable. The resources of the FSO amounted to $5,436 million. United States subscriptions to IDB capital shares amounted to $2,409 million, or 39 percent of the total. Including contributions authorized, but still pending appropriation, the United States accounted for $3,640 million or 70 percent of total resources contributed to the FSO.

In fiscal year 1976, the IDB borrowed $335 million equivalent in international capital markets including $150 million in the United States. In addition, the Bank sold $34 million in two and five-year bonds to central banks in Latin America. The Bank's funded debt amounted to $1,816 million equivalent as of June 30, 1976.

Major Policy Issues and Developments

Annual Meeting: At the seventeenth Annual Meeting of the IDB, held in Cancun, Mexico in May 1976, the two major subjects which the United States Temporary Alternate Governor dealt with in his speech were the status of Congressional action on the new replenishment of the Bank's resources and the adequacy of the Bank's lending rate on Ordinary Capital loans.

In addition, while commending the Bank for expanding its lending to the agricultural sector and its assistance to the poorest peoples of Latin America, the United States urged IDB management to give more attention to improving the quality of loans, improving estimates and control of project costs, and increasing supervision of projects underway. The United States also suggested that consideration be given to cancelling balances in old, slow-disbursing, loans in order to free up scarce resources. It was urged that the limited resources of the Fund for Special Operations be reserved for those countries most in need of concessional assistance and that middle-income countries increasingly shift their borrowing to Ordinary Capital and to the Venezuelan Trust Fund.

While applauding the initiation of a program of complementary financing to increase the flow of private financial resources to development projects in Latin America, the United States urged the IDB to place highest priority on expanding such cooperative arrangements with the private sector. The United States stressed its conviction that the Bank should increase support to the private sector in Latin America through greater lending to productive enterprises outside the public sphere and through loans to credit institutions which assist in mobilizing domestic savings.

Replenishment of IDB Resources and Nonregional Membership: On May 31, 1976 final Congressional action on a bill was completed and signed into law authorizing the United States to vote for a replenishment of the Bank's resources, as well as for amendments to the Bank's Charter permitting nonregional membership in the Bank. The Secretary of the Treasury, as the United States Governor of the IDB, voted on June 1, 1976, in favor of the amendments to the Bank's Charter and of the replenishment resolution. The United States vote brought the replenishment and Charter amendments into effect.

Under the terms of the replenishment agreement, the regional member countries (including the United States) will provide the Bank with $6,145 million in additional resources over the period 1976 to 1979, of which $5,100 million would consist of assigned subscriptions to capital shares ($332 million paid-in and $4,768 million callable) and $1,045 million in contributions to the FSO. In voting for the replenishment resolutions, the United States also formally agreed, subject to appropriation of the necessary amounts by Congress, to subscribe to $1,650 million in capital ($120 milion paid-in and $1,530 million callable) and to contribute $600 million to the FSO, as part of the total replenishment of IDB resources.

Reflecting the growth of their economies and the improved capacity of some members to share in financing the development of the poorer countries of the region, the Latin American share will be 58 percent ($3,588 million), in contrast to 48 percent in the preceding replenishment (initiated in 1970). The United States share would decline from the 52 percent of the last replenishment, to 37 percent. Another significant feature of this replenishment is that Argentina, Brazil, Mexico, Venezuela, and Trinidad and Tobago have agreed to refrain from borrowing dollars from the FSO during the current 1976 to 1978 replenishment period and to make convertible all or part of their own contributions to the FSO.

The legislation authorizing United States participation in the replenishment also enabled the Secretary of the Treasury to vote in favor of the nonregional membership resolution. Nine nonregional countries (Belgium, Denmark, Germany, Israel, Japan, Spain, Switzerland, the United Kingdom and Yugoslavia) formally joined the Bank on July 9, 1976, and Austria, the Netherlands, Italy and France were expected to become members before the end of calendar year 1976. The thirteen nonregional countries will, together, subscribe to $434.3 million ($71.7 million paid-in and $362.6 million callable) of IDB capital shares and contribute an equal amount to the FSO.

Early in fiscal year 1976, the IDB Board of Executive Directors adopted a policy which provided that, on the entry of the nonregional countries into the Bank, procurement financed under loans made with resources provided to the Bank as a result of the new replenishment or nonregional membership would be unrestricted as among member countries. Because only nine of the thirteen nonregional countries joined the Bank in July, this policy was revised to permit the remaining four countries which had not yet completed the legal steps necessary for them to join the Bank, to remain eligible for procurement under IDB loans, for a period of six months, provided they allow the Bank to have continued access to their capital markets.

Lending Rate on Capital Loans: One of the major policy issues of interest to the United States and to other members of the IDB during the fiscal year concerned the Bank's lending rate on capital loans. It was proposd that IDB member countries consider structuring the lending rate so that it would move automatically with the cost of capital to the Bank, with sufficient spread above borrowing costs to cover administrative and liquidity costs. The United States proposal was prompted by concerns arising from the sharp increase in the Bank's annual level of disbursements and borrowings, and the possible adverse impact these would have on the Bank's creditworthiness in international capital markets in the absence of an interest rate which fully covers costs and permits additions to reserves.

After the Bank's Annual Meeting, the Bank staff analyzed the adequacy of the 8 percent lending rate on capital loans, with special emphasis on an appropriate interest rate for the new interregional capital. On September 30, 1976, a decision was made by the Board of Directors which provides that the new lending rate would be based on a two-part formula: a calculation of the Bank's previous borrowing costs plus a spread to cover the Bank's administrative and liquidity costs. The lending rate will be adjusted annually on July 1 on the basis of a calculation of the borrowing costs over the preceding twelve months plus a spread to cover administrative and liquidity costs. Under the new formula, the lending rate on capital loans would be 8.6 percent for the period beginning July 1, 1976. The lending rate will be adjusted on January 1 of each year, if at the end of each December borrowing costs record an increase or decrease by as much as .15 percent or more over the borrowing costs determined the preceding June 30. This lending rate formula will be subject to periodic review. The 7 percent lending rate currently applicable to the export financing program is being studied within the Bank with a view to raising it to the same rate charged for all other lending out of Ordinary Capital.

Harkin Amendment: The legislation authorizing United States participation in the current IDB replenishment contains a human rights provision (Harkin Amendment) which requires the United States Executive Director of the IDB to vote against the extension of any assistance to any country engaging in a consistent pattern of gross violations of internationally-recognized human rights unless such assistance will directly benefit the needy people in such country.

On June 18, 1976, the United States Executive Director voted against a $21 million Ordinary Capital loan to Chile for industrial credits. At that time he pointed out that the United States' "no" vote was necessary on human rights grounds under the Harkin Amendment, and added that the United States would continue to keep the human rights situation in Chile under review.

ASIAN DEVELOPMENT BANK

Lending Program

Our participation in the Asian Development Bank (ADB) is an important element of United States foreign economic policy in the post-Vietnam period. Major ADB borrowers—Korea, the Philippines, Malaysia, Indonesia, and Thailand —are countries of particular political and economic importance to the United States. Forty-two nations, both regional and nonregional, are members of the ADB.

During fiscal year 1976, the Asian Development Bank lent $883 million to its borrowing member countries, a 55 percent increase over lending in fiscal year 1975. This figure is artificially high because 60 percent of the Bank's calendar year 1975 loans were approved between October and December of that year. In the Bank's next financial year (calendar year 1976), it successfully sought to reduce this "bunching" by approving more loans earlier in the year. These two actions occurred during the United States fiscal year 1976 leading to the high total loan and growth figures. Growth between the Bank's fiscal years 1974 and 1975 was 20 percent. Recognizing the distorting effect, fiscal year 1976 loans from Ordinary Capital resources accounted for $669 million, and Special Funds resources for $214 million. Lending in fiscal year 1976 brings cumulative ADB lending through June 30, 1976 to $2,944 million —$2,206 million from Ordinary Capital and $738 million from Special Funds.

In fiscal year 1976, agriculture and agro-industries continued to be the largest beneficiaries of Bank lending, accounting for $262 million, or almost 30 percent of total lending. This is more than a 50 percent increase over the amount lent to agriculture in fiscal year 1975, and well over five times the amount lent to this sector in fiscal year 1974. Since the Bank's inception in 1966, public utilities have received the largest amount of ADB loan funds ($1,030 million, or 35 percent) followed by industry ($670 million or 23 cent) percent), and agriculture and agro-industry ($661 million, or 22 percent).

The four largest borrowers from the ADB's Ordinary Capital resources in fiscal year 1976 were Korea ($135 million, or 20 percent), Indonesia ($126 million, or 19 percent), Philippines ($119 million, or 18 percent), and Thailand ($112 million, or 17 percent). While these four countries received 74 percent of Ordinary Capital lending in fiscal year 1976, this was lower than the 81 percent borrowed by these four countries during the preceding fiscal year. Burma and Pakistan were the two largest recipients from the ADB's Special Funds, having borrowed $77 million (36 percent) and $56 million (26 percent) respectively in fiscal year 1976.

Resource Requirements

ADB Ordinary Capital lending operations are financed by paid-in capital subscriptions, funds borrowed in private capital markets and from governments and central banks (backed by convertible callable capital subscriptions), repayments of principal and interest on loans, and net earnings on investments. Special Funds/Asian Development Fund resources—used for concessional loans—derive from member country contributions, amounts set aside from Ordinary Capital earnings, and repayments on loans.

As of June 30, 1976, the Bank's subscribed Ordinary Capital stock totalled $3,202 million. The Administration's request for a second United States installment of $120.6 million to the first Ordinary Capital increase was approved on June 30, 1976 and the United States subscribed this amount on July 27, 1976 raising the total United States capital share to $482.5 million. This subscription, plus a Canadian special increase of $156 million effective on September 1, 1976, raised the Bank's capital to a total of $3,479 million.

In fiscal year 1976, the Bank borrowed $539 million in international capital markets—an amount in excess of its cumulative borrowings through fiscal year 1975. The ADB raised $225 million in the United States, $82 million in the Netherlands, $67 million in Germany, and $50 million in Japan.

Because of higher borrowing costs, on August 5, 1976 the ADB Board of Directors raised the standard interest rate on Ordinary Capital loans, retroactive to June 8, from 8.75 percent to 9.1 percent. It also raised the effective commitment charge on all undisbursed loans from 34 to 45 basis points. In addition, the Board of Directors supported a proposal for a Bank staff study of methods for determining the Bank's interest rate and alternative systems for interest rate adjustment. On September 7, 1976, the ADB Board raised the interest rate on loans to its relatively affluent borrowers from 9.5 percent to 9.7 percent by establishing a 60 basis point premium on loans to developing members with 1972 per capita incomes above $850 equivalent. The Board also called for a study of the question of premium rates and the graduation of more affluent borrowers from borrowing eligibility.

In fiscal year 1976, the Bank continued the review of its financial and resource situation. On September 7, 1976 the Board of Directors recommended a $4.96 billion capital increase to finance Ordinary Capital lending from mid-1977 through 1981. In December, 1975, the ADB Governors approved a Resolution which called for a 1976–78 ADF replenishment of $830 million including a suggested U.S. contribution of $231 million. (See discussion below.)

Major Policy Issues and Developments

At the Ninth Annual Meeting of the Board of Governors of the Asian Development Bank in Jakarta, Indonesia in April 1976, spokesmen for the United States expressed support for the ADB's emphasis on increasing lending to the agricultural sector and for programs which directly benefit the rural poor. Bank management efforts to increase the utilization of appropriate intermediate technology and to mobilize co-financing for development projects, (thus contributing to more efficient use of the Bank's capital resources) were also commended. The United States also called on the Bank to explore the feasibility of equity investments in productive, employment-creating enterprises as is permitted by its Articles of Agreement. Hope was expressed that final agreement would soon be reached on replenishing the Asian Development Fund and increasing the Ordinary Capital of the Bank.

Asian Development Fund: By the end of calendar year 1975 the ADF had nearly exhausted its commitment authority, with only $40.9 million available for new loans. Aware of the impending exhaustion of concessional resources and concerned about the resulting impact on the poorest Asian nations, representatives of ADF donor countries met during the spring and summer of 1975 to negotiate a replenishment of these resources. During these multilateral negotiations a formula was developed whereby most donor countries agreed to contribute amounts equal to approximately 150 percent of their original contributions to the Fund. The United States reiterated its continuing support for the ADF, but could not give any commitment on the size or timing of its contribution. Recognizing the United States reservation, the ADB Board of Governors approved, in December 1975, a 1976–78 replenishment of the ADF totalling $830 million. The United States abstained on this resolution noting that our suggested contribution of $231 million was too high. Foreseeing this, the resolution permitted donors to change their contribution levels subject to approval by the ADB Board of Governors. After consultations with Congress in June 1976, the Administration requested that the United States contribution be set at $180 million and, on September 10, 1976, the ADB Board of Governors approved the new United States level and a reduction in the New Zealand contribution from $9.2 million to $5.4 million. These downward adjustments were partially offset by a $34 million increase in the Canadian contribution.

Ordinary Capital Increase: Another major topic discussed at the Jakarta meeting was a second general capital increase for the Bank to finance Ordinary Capital lending from mid-1977 through 1981. Commitment authority derived from the first general capital increase and special capital increases by selected members would be exhausted by mid-1977 if the Bank was not to exceed its ceiling on borowings of 75 percent of convertible callable capital.

In November 1975 Bank management proposed a capital increase equal to 135 percent of capital subscribed as of mid-1977. This would amount to about $4.96 billion (of which 15 percent would have been paid-in capital) and would permit Ordinary Capital lending to increase by about $75 million per year from 1977 through 1981. Discussions in the ADB Board continued through early calendar 1976 with representatives of the United States urging efforts by the Bank to improve its financial position through changes in its financial policies so as to reduce dependence on paid-in capital. On September 7, 1976, the Bank's Board of Directors voted to recommend to the Board of Governors ratification of a 135 percent increase in 1977 subscribed capital including 10 percent paid-in capital.

Vietnam Membership: A South Vietnamese delegation attended the ADB's Annual Meeting in Jakarta and raised the issue of the resumption of ADB lending to Vietnam under agreements signed between the previous government and the ADB. The Bank had approved loans to South Vietnam totalling $44.6 million, of which $24.0 million were effective when the Bank suspended its lending operations in Vietnam in April 1975. A total of $5.7 million had been disbursed under these ADB loans.

On July 20, 1976 the ADB received a cable from the newly constituted Socialist Republic of Vietnam (SRV) indicating it would continue the former Republic of Vietnam's status as an ADB member. The Bank acknowledged receipt of the cable but began an investigation into the entire issue before seating the SRV. It was the United States position that before any lending activities were resumed, the SRV should demonstrate its willingness to fully assume the obligations attendant on membership including those relating to loans previously extended to the Republic of Vietnam and the Bank should review the economic viability of the projects for which the loans were originally extended. The United States believes that the Vietnamese must accept all of the duties and responsibilities of membership and participation in the ADB. These would include the requirements of accepting competitive international bidding, Bank supervision of projects, and access to official economic data.

On September 23, 1976, following similar actions in the IMF and IBRD, the ADB Board voted to accept accession of the Socialist Republic of Vietnam to membership in place of the previous government. The Bank released communications from the SRV indicating the Vietnamese recognized publicly their responsibility for previous loans. The United States Director voted against the proposal, stating that the decision to accept the SRV was premature and that the United States remains uncertain regarding SRV willingness to carry out fully its international obligations.

African Development Fund

The African Development Fund (AFDF) was created on July 3, 1973, as the concessional lending affiliate of the African Development Bank (AFDB). The AFDF is designed to channel non-African resources into the African development process and to help meet the need for softer terms for projects in those African nations which could not borrow on the terms offered by the AFDB.

At the end of fiscal year 1976, AFDF membership included twelve European countries, Canada, Brazil, Japan, Saudi Arabia, and the AFDB representing all of its member states. In anticipation of our joining, the Governors of the Fund adopted a resolution at the Annual Meeting of the African Development Bank and Fund in

Kinshasa, Zaire, in May, 1976, permitting the United States to join as soon as the necessary authorization was available.

Congress subsequently authorized United States membership at a level of $25 million and appropriated $15 million for the initial United States contribution. The United States formally joined the AFDF in mid-November 1976. With the United States contribution of $15 million, total resources pledged to the Fund are expected to amount to $410 million, up from an initial figure of $100 million in 1973.

The growth in the Fund's lending activities has been consistent with the growth in resources. In calendar year 1974, the first full year of operation, AFDF lending totaled $46.2 million. In 1975, the rate of lending almost doubled to $92 million. The Fund expects to lend $100 million in calendar year 1976, and plans to increase its program further in subsequent years. All loans carry a service charge of 0.75 percent per annum on the disbursed amount with a repayment period of 50 years, including a ten-year grace period. The Fund has concentrated primarily on the development of agriculture and transportation, but has also been active in lending to the public utility, health, and education sectors.

In fiscal year 1976, the National Advisory Council considered the level of United States participation in the Fund, and recommended that in fiscal year 1978 appropriation of the final $10 million remaining under the authorizing legislation be sought from Congress to enable the United States to assume an appropriate role in the African Development Fund.

International Fund for Agricultural Development (IFAD)

In fiscal year 1976 the United States actively participated in international negotiations aimed at establishing the International Fund for Agricultural Development (IFAD). Originally sponsored by OPEC countries at the November 1974 World Food Conference, IFAD is a proposed $1 billion fund to provide concessional assistance for increased food production in the poorest food-deficit developing countries.

Meeting in Rome in June 1976, the United Nations Conference on the Establishment of IFAD adopted the Articles of Agreement, received and recorded pledges of the equivalent of about $935 million in convertible currencies, and established a preparatory commission. The Conference did not open the Agreement for signature, since total pledges in convertible currencies fell short of the $1 billion target specified in the Agreement. Instead, the Conference decided that if the $1 billion is not obtained by September 30, 1976 a meeting of all prospective IFAD members will be called to determine whether this target should be lowered. However, since convertible currency pledges totalled the equivalent of about $970 million at the end of September, 1976, the IFAD Preparatory Commission decided to delay a decision on calling the meeting.

TOPICS OF SPECIAL INTEREST

United States Procurement Trends in the IDLIs

Total procurement of United States goods and services from IDLI-financed projects amounted to $627.8 million in calendar year 1975, 19.5 percent of all procurement generated by these projects. The percentage of procurement won by American exporters on IBRD/IDA projects remained relatively stable at 17.6 percent ($459 million) in fiscal year 1976 as compared with 17.7 percent ($391 million) in fiscal year 1975. The United States percentage of procurement in the IDB rose from 46.5 percent ($103 million) in calendar year 1974 to 49.7 percent ($152 million) in calendar year 1975. Although the United States share of total ADB contract awards fell from 11.5 percent ($40 million) in calendar year 1974 to 6.6 percent ($22 million) in calendar year 1975, the United States average share of awards for services related to ADB financed projects for the period 1966 through 1975 rose from 23 percent at the end of 1974 to 32 percent at the end of 1975. Awards for consulting services are made on the basis of the suitability of a firm's qualifications for the work in question rather than on a price-competitive basis.

World Bank and IDB procurement share data are on a disbursement basis while ADB data are based on the dollar value of contracts awarded. The World Bank-IDB method entails a significant lag between the time a contract is awarded and the time funds are disbursed for the delivery of equipment. Though the ADB method does not involve such a lag, there may be changes in the initial amount of the award which are never reflected in the procurement share statistics.

The improvement in the United States share of IDB procurement can be attributed largely to the impact of the currency realignments of 1971 and 1973, which made American goods and services more price competitive. World Bank and ADB statistics reflected this improvement in earlier years, perhaps due to different data-recording practices. The increase was more pronounced in the IDB because of our strong traditional trade ties with the Latin American countries.

The reasons for the second consecutive reduction in the United States share of ADB contract awards are difficult to identify. Preliminary studies suggest that American firms are not bidding on these projects. Historically, the United States has not had an established trading relationship in South and East Asia, and the American firm's familiarity with business practices and customs of the area is not as thorough as that of some other countries. For these reasons, American firms have not been as aggressive in seeking out and developing opportunities as have been some of their foreign counterparts.

In an effort to identify some of the factors which affect the United States share of IDLI-financed procurements, a Treasury-sponsored report was in preparation during the past year which examines the situation from the perspectives of the banks, the United States Government, and the American business community. The draft report is currently being reviewed by the NAC agencies.

The Treasury Department continues to coordinate actively with other United States Government agencies involved in promoting and supporting American business interests abroad to ensure that appropriate priority is given IDLI-financed procurement.

IDLI Salary Levels and Administrative Costs

In fiscal year 1976, the level of salaries and other remuneration in the IDLIs continued to receive attention from Congress, the Executive Branch, and in a report to Congress by the General Accounting Office. The United States vigorously opposed excessive salary increases in the IDLIs in a series of high level representations to other member governments and IDLI managements. Some success resulted from these efforts. During the summer of 1975, a proposed $3,500 increase in the salaries of the Executive Directors and Alternate Executive Directors at the IBRD and IMF was defeated in a vote of the Boards of Governors of the institutions. Subsequently, an increase of $1,500 was approved, with the United States voting against the proposal.

In the spring of 1976, the United States was successful in helping to defeat proposed salary increases at the IBRD and IMF ranging from 7.3 percent to 8.8 percent. Instead, a straight cost-of-living increase was approved. More support was received from other governments in this particular campaign than had been evident in previous campaigns. The failure of the IMF management's proposal resulted in a one-day work stoppage at the IMF. The work stoppage helped generate an increasing amount of press coverage, highlighting the high level of salaries already existing in international organizations.

In July 1976 a proposed increase in Executive Directors' salaries of $3,000 at the IBRD and IMF was defeated. The margin of defeat for the proposed increases in Executive Directors' salaries was much larger than in 1975, with 23 countries supporting the United States in the IMF, and 26 in the IBRD, compared to 14 countries in 1975. Support for the United States position has come largely from the developed countries where calls for salary restraint often coincide with domestic incomes or budgetary policies. Support from the LDC has been slower to develop although some progress is discernible.

The General Accounting Office, in its report on IDLI salaries, commented that these salaries were larger than those of any member government. It recommended that the Treasury Department coordinate the development of policy positions on appropriate salary levels in the IDLIs, with State Department officials responsible for United States participation in other international organizations. Following these recommendations, the United States will continue to present its case for salary restraint in international organizations, with the objective of gradually bringing salaries more into line with those of national civil services. An inter-agency group on international organization remuneration is studying the problem, as recommended by the General Accounting Office.

With regard to administrative budgets, the United States was successful in obtaining modest cuts in the proposed budget at the Inter-American Development Bank, and recommended increased efficiency measures at the other IDLIs.

IDLI Loans for Extractive Industries

Satisfactory economic growth of all countries, both developed and developing, depends heavily on the availability of minerals and other industrial raw materials. The availability of these materials, in turn, depends on whether there is adequate ongoing investment in new mineral sources to assure adequate supplies. The developing countries have an added stake since mineral exports already account for 15 to 20 percent of LDC non-oil exports, and could be substantially increased.

The World Bank's Articles of Agreement provide that it should encourage international investment by helping develop the productive resources of members, and for Bank activities to supplement private investment when private capital is not available on reasonable terms. The IDLIs have financed projects in the extractive industries for many years. This activity has increased greatly during fiscal year 1976.

During Board discussions this past fiscal year and in accordance with the United States position established earlier, the United States Executive Director recommended the World Bank consider financing only infrastructure and restrict Bank financing of directly productive activities to exceptional cases where efforts, even with a good investment climate, have been unsuccessful in attracting private capital. The United States Director noted that there are times when the Bank, particularly the IFC, could act as a "middleman" between foreign private investors and local investors, and between the investors and the government.

The United States Executive Director has also recommended that the IFC continue to take the lead in encouraging and promoting investments in directly productive investments. In some cases, the IFC can assist in such arrangements provided an enterprise continues to be essentially private and market-oriented. A good example of such an operation is the IFC loan for the Cuajone mining project in Peru made in 1975.

The IBRD has also undertaken to study the United States initiative on the International Resources Bank (IRB). The IRB (discussed in Chapter II of this Report) would mobilize and encourage private capital, and management, including technology for resource projects in developing countries.

Appropriate Technology

During the past fiscal year, Congress mandated the IDLIs to focus their development strategies on light capital technology. It is the Congressional view that the effectiveness of IDLI lending would be greatly enhanced by increasing the use of light capital technologies in project execution and that these technologies should become one of the cornerstones of IDLI development strategy. Proponents of light capital technologies believe that the type of capital equipment used in project execution should conform to the economic realities of the borrowing country. It is felt that such factors as relative supply of labor to capital, level of training of the work force, and daily wage rates should determine the appropriate technology employed.

Congress has specifically requested, as part of the Inter-American Development Bank Act of 1976, that the United States Executive Director propose to the IDB Board of Executive Directors a resolution which would make the development of intermediate technologies a major facet of the IDB's development strategy. A progress report to Congress is required in November 1976. Reports of the House Appropriations Subcommittee on Foreign Operations for fiscal years 1976 and 1977 appropriations have also strongly urged that the other IDLIs expand the scope of their activities in this field.

Commodity Problems

The United States Government's review of IDLI-financed projects extends beyond assuring itself of the priority of the project and its economic and technical feasibility. The United States, through the National Advisory Council on International Monetary and Financial Policies (NAC), reviews whether the output of the project will contribute to world surplus conditions for a particular commodity and whether the additional supply will depress prices below a level at which most current suppliers can earn a reasonable return. When this condition is found to exist, the United States Government recommends that alternative projects be financed.

During the past several years, IDLI projects for several commodities whose prices have been subject to wide fluctuations have been intensively reviewed by the United States Government. Three years ago the United States reviewed and revised its policy of longstanding opposition to IDLI financing of sugar projects because of the shortages and high prices at that time and the projected shortages for the foreseeable future.

Currently, the United States is concerned about surplus conditions developing in fats and oils markets, particularly for palm oil, and also whether the United States should continue to support further IDLI financing of palm oil export projects in the developing countries.

An NAC Working Group was established in fiscal year 1976 to study this problem and develop guidelines for reviewing future IDLI palm oil projects. The guidelines developed by this Working Group benefitted from a study done by the United States Department of Agriculture

(USDA) on world prospects for oilseeds and fats. The USDA study indicated there is not likely to be a strong market for palm oil in the future; thus the Working Group recommended caution be employed in supporting further IDLI projects for palm oil. The guidelines recommended by the Working Group and adopted by the Executive Branch are as follows: (1) Loans for palm oil projects intended primarily to produce oil for domestic consumption in the borrowing country will be approved. (2) Loans for palm oil projects in countries with established palm oil industries capable of obtaining commercial financing will not be approved. (3) Other loans for palm oil projects that are currently being prepared for Executive Board consideration and intended to produce palm oil for export will be approved if the projects are commercially viable. (4) The United States should convince the IDLI management to find alternatives to palm oil export projects when developing new projects for Executive Board consideration. (5) The NAC should review, as necessary, these guidelines for United States approval of IDLI financing of palm oil projects. These guidelines are currently being implemented.

Another commodity currently being monitored closely is tobacco. The United States has opposed IDLI financing of tobacco projects in the past and is continuing to do so. The production and marketing of tobacco is controlled and/or subsidized extensively by governments, thus limiting the effective functioning of free market forces.

INVESTMENT STATUS OF IDLI BONDS

Pursuant to provisions in the Acts authorizing United States participation in the IDLIs and to amendments to the National Bank Act, member banks of the Federal Reserve System are permitted to underwrite and deal in IDLI securities for their own account within defined limits. Although the institutions file annual reports with the Securities and Exchange Commission, securities issued or guaranteed by them are exempted by statute from the Securities Act of 1933 and the Securities Exchange Act of 1934. The provisions of law just described facilitate to an extent the sale of bonds by the respective institutions, and the National Advisory Council does not recommend any modifications of the statutes.

In addition to Federal legislation facilitating the sale of bonds by the IDLIs, State laws provide for the purchase of such bonds as legal investments by various financial institutions. The status of qualification of IDLI bonds for this purpose is summarized in Table 8.

TABLE 8.—*Number of States*[1] *in which IDLI securities are qualified for investment by financial and fiduciary institutions as of June 30, 1976*

Eligible institution	International Bank for Reconstruction and Development	Inter-American Development Bank	Asian Development Bank
Commercial banks	50	50	49
Savings banks[2]	29	32	30
Insurance Companies:			
Life	50	47	48
Other	48	44	45
Trust funds	48	48	49
State and local pension funds	40	43	41

[1] The securities of the International Bank for Reconstruction and Development and of the Inter-American Development Bank are eligible for investment by all of the listed institutions in the District of Columbia except for pension funds which must be invested in U.S. Government securities. The securities of the Asian Development Bank are eligible for investment by all of the listed institutions in the District of Columbia except for life insurance and fire and casualty insurance companies and pension funds.

[2] Savings banks exist as a separate category of savings institutions in 33 States.

V. TRADE POLICY AND FINANCE

• Although world trading nations continued to experience serious economic and financial pressures stemming from the global economic decline and the problems created by higher energy prices, no significant, generalized, retreat to restrictive or protectionist trade policies was evident during fiscal year 1976. Exceptions to this norm were, essentially, temporary measures taken to meet particular problems and were not, as a general rule, broad in scope.

• The commitment of the United States to a free and open international trading system is reflected in the dominant and active role it played in trade matters at the Rambouillet and Puerto Rico Economic Summit Conferences. Participants in these Conferences joined in opposition to trade-distorting and protectionist measures, called for an acceleration of the Multilateral Trade Negotiations (MTN), and agreed to intensify and strengthen relationships among major trading areas in order to achieve a long-term goal of maximum trade expansion.

• Significant changes in export credit programs occurred during fiscal year 1976 including achievement of a consensus among a number of the major trading countries, including the United States, that counterproductive competition must be avoided in the field of government-supported export credit programs.

• The Export-Import Bank of the United States (Eximbank) established a new and higher range of standard interest rate charges which brought the cost of its loans closer to those available commercially and at the same time improved Eximbank's earning potential so that lower rates could be charged to meet proven foreign competition.

• During fiscal year 1976 Eximbank authorized $8.6 billion in loans, guarantees and insurance in support of $12 billion of United States exports.

• Agricultural exports under the CCC export credit sales program for fiscal year 1976 (plus the first month of the Transition Quarter) amounted to approximately $740 million as compared with about $250 million of agricultural exports financed under this program during fiscal year 1975.

• Commodity programming under Title I of Public Law 480 (P.L. 480) totalled $914 million, for 5.1 million metric tons of United States agricultural commodities, during fiscal year 1976. This compares with P.L. 480, Title I commodity programming of $972 million, for 3.6 million metric tons of commodities, in fiscal year 1975. Commodity quantities shipped under the Title II P.L. 480 program (donations) amounted to 874,000 metric tons, valued at $314 million, during fiscal year 1976.

THE WORLD TRADE ENVIRONMENT IN FISCAL YEAR 1976

Fiscal year 1976 was a period of recovery by the United States from the most severe recession it had experienced since the 1930's. During this recessionary period, which extended from 1974 through late 1975, real output in the major industrial countries fell sharply and, for the first time since World War II, the aggregate volume of world trade declined. Solid progress toward economic recovery has, however, been recorded in the industrial countries since early in calendar year 1976 although the threat of inflation persists and unemployment levels remain high. Many problems nonetheless remain and the developing countries and several of the industrial countries are encountering significant foreign trade problems which could become particularly acute if energy (oil) prices are further increased.

Despite serious pressures from unemployment and balance of payments problems caused by the global economic decline and increased oil prices it is encouraging to note that there has been no significant or general retreat to restrictive and protectionist trade policies. Although there were some exceptions to this general rule, such measures as have been introduced have typically been of a temporary character and narrow in scope.

In mid-December 1975, the United Kingdom, faced with serious economic and financial problems and a significant deterioration in the position of the pound sterling, introduced import restrictions on a limited number of products. While these measures are not expected to result in serious limitations for United States exports, they involve items, such as textiles and footwear, of considerable importance to other countries. While it was recognized that the United Kingdom was in fact encountering serious difficulties, the United States felt it was necessary to express its concern with regard to the imposition of these restrictions by raising the issue in bilateral consultations with the United Kingdom as well as in the frameworks of the General Agreement on Tariffs and Trade (GATT) and the Organization for Economic Cooperation and Development (OECD). In consultations with the United Kingdom, the United States stated its intention to examine how the trade impact of these measures could be minimized and to review the measures, on a continuing basis, to assure their removal at the earliest possible date.

Several other countries also instituted restrictive trade measures during fiscal year 1976. A prior import deposit scheme introduced by Finland in early 1975 was examined in the GATT during the year and was phased out in March 1976. Brazil introduced a prior import deposit scheme during the last half of calendar year 1975 which was reviewed at a GATT Balance of Payments Committee meeting in May 1976. No date has yet been set for terminating this scheme. Italy also instituted a prior deposit requirement for lira purchases of foreign currency in May 1976. This deposit requirement was initially to remain in force for three months but was extended for an additional period.

The measure is characterized by the Italian Government as an emergency step to relieve a deteriorating balance of payments situation which had led to a substantial depreciation of the lira. The United States indicated it wanted consultations on this issue in the GATT Balance of Payments Committee and Italy has agreed to the creation of a Working Party to review the measure.

In August 1976 South Africa introduced an import deposit scheme (IDS) to help deal with its deteriorating balance of payments position. The United States informed South Africa that it wanted consultations in the GATT Balance of Payments Committee on this scheme (which was notified to the GATT) and at a GATT Council meeting South Africa agreed to such consultations.

During the fiscal year Portugal instituted import surcharges ranging from 20 to 30 percent on various categories of imports. The surcharges were reviewed in the GATT and were not found to be excessive. No date has been fixed for the termination of these surcharges.

In July 1975 Mexico instituted a program of intensified import restrictions on selected nonessential imports implemented largely through the import licensing system. Certain other items were placed under import quotas or subjected to complete prohibition. The United States, in bilateral consultations with Mexico, has expressed its concern with these measures.

Australia imposed temporary tariff quotas on imports of cold-rolled steel sheets and plates in April 1976. This action was a renewal of short-term, emergency, measures imposed by Australia in early 1975 on steel and certain textiles. The United States joined other countries in requesting consultations on compensation for these restrictions on imports of steel plates, and also made bilateral representations on the restrictions to the Australian Government and in the GATT and the OECD.

New Zealand introduced a prior import deposit scheme covering about 7 percent of its imports in January 1976. The rationale for the scheme was based on that country's balance of payments difficulties. New Zealand notified the GATT Council of the prior import deposit scheme which was subsequently taken up in a GATT Working Party in February 1976.

The United States opposes the introduction of protectionist measures which limit the free flow of trade, and strives to prevent the proliferation of such measures. This commitment of the United States to the principles of free trade has been, and continues to be, articulated in a number of international forums in which the United States attempts to ensure that the concept and spirit of free and open markets becomes an essential integral feature of the world's trading system.

UNITED STATES TRADE POLICY INITIATIVES AND ACTIVITIES

The Rambouillet and Puerto Rico Economic Summit Conferences

Our commitment to a free and open trading system is exemplified by the dominant and active role the United States played in the Economic Summit Conferences of Rambouillet (November 1975) and Puerto Rico (June 1976). The Rambouillet Conference, attended by the leaders of the United States, France, the United Kingdom, Japan, West Germany, and Italy, was convened with recognition of the close interrelationships between international trade and national economic policies, and directed towards attaining agreement that cooperative efforts will be made to ensure that greater stability in the economic and financial conditions of the world prevails as the recovery proceeds. To this end, the participants joined in opposing measures which distort trade and lead to a resurgence of protectionism.

The Rambouillett Declaration called for an acceleration of the current Multilateral Trade Negotiations (MTN) and proposed that 1977 be set as the target date for completion of these negotiations. The participants at the Rambouillet Conference also expressed agreement with the objectives of the MTN as set forth in the Tokyo Declaration, *viz.*, ". . . that the negotiations should aim at achieving substantial tariff cuts, even eliminating tariffs in some areas, at significantly expanding agricultural trade and at reducing non-tariff measures . . ." so as to achieve the maximum possible level of trade liberalization.

The Puerto Rico Conference, attended by the leaders of the six countries present at Rambouillet plus the Canadian Head of State, reaffirmed these goals and concluded with agreement by the participants to continue to intensify and to strengthen relationships among major trading areas, again with the long-term objective of maximum expansion of trade.

The OECD Trade Pledge

The United States joined with other member countries of the OECD in June 1976 to reaffirm the commitment to free trade through renewal of the OECD Trade Pledge for the second consecutive year. The OECD Trade Pledge reflects the mutual determination of participating countries to avoid imposition of trade or other current account restrictions for balance of payment reasons and to cooperate in seeking common solutions to sectoral problems. The United States statement of renewal emphasized the themes of international interdependence and cooperation endorsed at the Rambouillet Conference and called on the major developed countries to adopt policies to assure a free and open order for world trade and investment.

UNCTAD IV

The UNCTAD United Nations Conference on Trade and Development held its fourth conference in Nairobi, Kenya, in May 1976. As indicated earlier in this Report, this conference was convened to discuss the problems being encountered by the developing countries in many areas of trade and economic development, to review their objectives and their specific requests, and to seek ways and means of helping to solve the problems of the developing countries. The principal objectives of the developing countries, particularly the non-oil producers, as stated at this conference were: establishment of an integrated program for commodities including a common fund to finance buffer stocks, with the goal of stabilizing prices, in real terms, for a core group of raw material commodities; agreement on a scheme for a generalized moratorium on debt; agreement on improved terms to govern the transfer of technology from developed to developing nations; a greater flow of aid to the poorest among the developing countries; and, improved access to Western developed country markets.

The importance the United States attaches to resolving the problems facing the developing countries was reflected in the senior level delegation sent to the UNCTAD IV meeting. Our position on the issues before the Conference was set forth in an opening statement by the Secre-

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tary of State. The general thrust of this statement was that the United States approached the talks in a serious and cooperative spirit and would endeavor to find methods of alleviating the economic concerns of the developing countries within the framework of an efficient world market system. More specifically, the United States indicated it was prepared to participate, on a case-by-case basis, in the examination of arrangements to improve the functioning of international commodity markets and follow-up on a number of other initiatives pertaining to the trade interests of the developing countries was also agreed upon, as indicated in Chapter II of this Report of the National Advisory Council.

Generalized System of Preferences (GSP)

In January 1976 the United States joined 22 other developed countries in instituting a Generalized System of Preferences (GSP) for the benefit of the developing countries. The United States system provides duty-free treatment, within specified limits, to imports of a wide range of products (chiefly semi-manufactures and finished manufactured goods, but also including agricultural and fishery products) from 98 developing countries and 40 territories or non-independent countries.

This system, which is to remain in effect until January 3, 1985, represents one component in a coordinated and concerted effort to integrate developing countries more fully into the international trading system. It is also intended to encourage diversification of developing countries' production and exports, so they may become more competive in world trade and less reliant on external assistance. The successful functioning of the system should also serve to expand market opportunities for all countries, including the United States. More than 2,700 items are currently eligible for preferential treatment under the system, the composition of the list of eligible items being subject to change in the exercise of Presidential authority to add or delete products on the list.

The Multilateral Trade Negotiations (MTN)

The Multilateral Trade Negotiations (MTN) were formally launched in September 1973, but the United States did not have the necessary authority to enter into negotiations until January 1975, when the Trade Act of 1974 was signed into law. With passage of this Act, the MTN progressed from a preparatory to a substantive phase.

The Trade Negotiations Committee (TNC), an intergovernmental committee which oversees and directs these negotiations, met twice during fiscal year 1976. The TNC met in mid-July, 1975 to review the progress made to that date and to identify areas where further progress could be achieved. The TNC met again in December 1975 at which time it endorsed the target date of 1977 for completing the negotiations called for at the Rambouillet Economic Summit Conference. It also agreed that achievement of this goal would require that substantial progress be made in several areas during calendar year 1976, including the nontariff measure (NTM) subgroups, agreement on a general tariff-cutting formula, and progress in the negotiations dealing with tropical products.

At both TNC meetings there was considerable debate on the treatment of agricultural products in the MTN. A procedural solution to this issue was agreed upon at the December meeting which did not compromise the basic interests of any country and will allow the negotiations to go forward. Substantive differences persist, however, between the United States and the European Community (EC) regarding the treatment of agriculture in the MTN. The United States' view is that agricultural goods should not be treated any differently than industrial products in these negotiations while the EC favors a special, sectoral, treatment for agricultural products in the MTN.

In the Tokyo Declaration of September 1973, the United States, along with other signatories, pledged to "secure additional benefits for the international trade of developing countries" including "a substantial improvement in the conditions of access for the products of interest to the developing countries." The developed countries expect the developing countries, in return, to make contributions as well although such contributions should not be "inconsistent with their individual development, financial and trade needs." The search for special and differential measures to apply to the developing countries and the contributions they might make has been an important agenda item in each area of the MTN.

Six functional negotiating Groups were created by the TNC in February 1975—Tariffs, Nontariff Measures, Safeguards, Sectors, Agricultural and Tropical Products. The Nontariff Measures and Agricultural Groups were disaggregated into subgroups covering quantitative restrictions, standards, customs matters, subsidies and countervailing duties, and dairy products, meats and grains respectively. These groups and subgroups met several times during fiscal year 1976.

Most of the *Tariff Group's* discussions have been devoted to developing a general tariff-cutting formula. Agreement on such a formula is a necessary and important initial step in implementing the negotations.

The United States and the EC presented tariff formula proposals to the Group earlier this year and it is anticipated that Japan and other key countries will also submit tariff proposals. Along with discussions of these tariff formula proposals the Tariff Group will continue to address the related questions of exceptions to the formula, base tariff rates and base dates to be used in the negotiation and the method of valuation (c.i.f., f.o.b.) to be utilized.

The United States is pressing for resolutions of these questions before the end of calendar year 1976.

The *Nontariff Measures Group* (NTM) serves primarily as an oversight body with actual negotiations on NTMs being handled by the subgroups. The quantitative restrictions (QRs) subgroup has been engaged in a process of notification and consultation through which countries are expected to identify and define those quantitative restrictions in which they have a direct trade interest and then to consult with the country or countries maintaining those restrictions. The subsidies and countervailing duties subgroup is engaged in a process of notification of other countries' subsidy practices, and in discussions of negotiating rules for subsidy practices.

The standards subgroup agreed to base its deliberations on the "Draft Code of Conduct for Preventing Technical Barriers to Trade" prepared by the GATT Committee on Trade in Industrial Products. The customs matters subgroup is engaged in discussions of the potential for development of a harmonized system of classification (nomenclature) for tariff and trade data (the subgroup agreed that substantive discussion of this subject should continue to take place within the Customs Cooperation Council in Brussels), and a harmonized system of customs valuation (the United States, Canada, and certain minor trading countries apply their own systems while other countries employ the Brussels Definition of Value). This subgroup is also engaged in a process of notification of excessive import documentation procedures.

A proposal submitted to the NTM Oversight Group in December 1975 to establish an additional subgroup on government procurement was approved in principle in April 1976. Extensive work on development of a government procurement code has been done in the OECD and, while there has been some progress on certain key elements of a draft code, disagreement still persists among the major OECD participants on other important sections of the proposed code.

The *Sectors Group* has been engaged in a study phase. Thus far, the GATT Secretariat has prepared detailed studies of the ores and metals, wood, leather, fish products, and paper sectors, and is preparing similar studies for other sectors.

In May 1976 the United States submitted to the MTN *Safeguard Group* a proposal for a revised multilateral safeguard system aimed at strengthening procedures and establishing certain broader obligations to ensure that actions are handled appropriately by the safeguard system.

The work of the *Agricultural Group* has, as already indicated, been delayed by a prolonged procedural dispute between the United States and the EC over the nature of negotiations on agricultural goods. The EC favors an autonomous negotiation for agriculture, while the United States favors negotiation for agricultural products under the general tariff and nontariff measure functional Groups. While this issue has not been resolved, an agreement was reached at the Group's December 1975 meeting to proceed with notification of tariffs and NTMs affecting trade in agriculture, with a view to circulating these notifications so that bilateral or plurilateral consultations on these restrictions may proceed.

Despite the procedural difficulties encountered by the parent Agricultural Group, the grains, dairy and meat subgroups are in active negotiating postures with each of the subgroups implementing work programs covering prospects for expansion and liberalization of trade, market stabilization and treatment of developing countries.

The *Tropical Products Group* has continued its item-by-item negotiation of products of interest to the developing countries. To date this Group has made more progress than any other Group in the MTN and it is anticipated that agreement on these negotiations could be reached during calendar year 1976.

While the negotiations in all Groups are moving forward, there will need to be substantial progress in the near future if the 1977 target date for completing the MTN is to be met. As a principal participant in the MTN the United States will continue to press for progress in the negotiations and will, as well, continue in this and other forums to work toward trade liberalization.

THE UNITED STATES SHARE OF WORLD TRADE

Although the global recession had a dampening effect on foreign trade—resulting in the first reduction in aggregate trade volume since World War II—the United States experienced a substantial shift, from deficit to surplus, in its merchandise trade account in calendar year 1975. Comparisons of our foreign trade account for calendar years 1974 and 1975 presented in Table 9 depict this turnaround from a trade deficit of $2.4 billion to a surplus of $11.1 billion ($3.8 billion when adjusted for cost-insurance-freight, cif). The major factor underlying this shift was a decline, both absolute and relative, in United States imports, accompanied by an increase in the value of our exports. As Table 9 indicates, with the exception of fuel imports (notably oil), which increased by only 4 percent, United States imports of all major categories of goods declined in calendar year 1975. This decline is attributable to several factors including the responsiveness of United States consumption to the cyclical downturn and the increased price of imports to American consumers caused by foreign price increases.

Exports, and particularly exports of American manufactured goods, increased during calendar 1975. The value of agricultural exports remained stable in 1975, while exports of manufactures rose by $8 billion (11.8 percent). More disaggregated estimates indicate that this increase in exports of manufactured goods consisted primarily of machinery exports, a large proportion of which was destined for OPEC countries. Particularly large gains were reported for exports of materials handling, drilling, and oil field and construction machinery.

These divergent trends led to a shift in the relative composition of United States trade, with a larger share attributed to non-agricultural items in calendar 1975 than in 1974. However, the distribution did not change drastically. The share of exports accounted for by agricultural products declined by only 2 percent, to 21 percent, while the share accounted for by manufacturing exports rose, to 79 percent.

While the volume of world trade declined by almost 4.9 percent in calendar 1975, the value of world trade increased by 3 percent. The United States experienced a similar decline in trade volume (2.7 percent). However, the value of our trade increased by 9.4 percent. Consequently, the United States accounted for an increased share of world trade (in value terms) in 1975—13.6 percent *vs.* 12.8 percent in 1974. The value of European Community (EC) trade also increased in absolute and relative terms in 1975, while Canada and Japan experienced reductions or very slight gains (absolute and relative) in trade in calendar year 1975.

During the first two quarters of calendar year 1976 the United States recorded a trade deficit of $1 billion (see Table 10). The primary cause of this deficit was the substantial imports of oil by the United States with a deficit of $13.2 billion reported in fuels. United States trade in manufactures and agricultural products continued, however, to register strong surpluses—$6.8 and $5.8 billion respectively—during the first half of calendar year 1976.

TABLE 9.—*United States Trade and Balance and Percent Changes, by Major Product Category, 1974–1975*
[F.A.S. Basis]

	1974			1975			Percent Change 1974–75	
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports
	(Billions of U.S. Dollars)			(Billions of U.S. Dollars)			Percent	
Total	97.9 (100)	100.3 (100)	– 2.4	107.2 (100)	96.1 (100)	11.1	9.4	– 4.2
Agriculture	22.3 (22.7)	10.4 (10.3)	11.9	22.1 (20.0)	9.5 (9.8)	12.6	– 0.9	– 8.7
Non-Agriculture	75.6 (77.2)	89.9 (89.6)	–14.3	85.1 (79.3)	86.6 (90.1)	– 1.5	12.5	– 3.7
Manufactures	63.5 (64.8)	55.2 (55.0)	8.3	71.0 (66.2)	51.1 (53.1)	19.9	11.8	– 7.5
Minerals/Metals	6.6 (6.7)	10.5 (10.4)	– 3.9	6.5 (6.0)	8.7 (9.0)	– 2.2	– 1.5	–17.1
Fuels	3.4 (3.4)	25.5 (25.4)	–22.1	4.5 (4.1)	26.5 (27.5)	–22.0	32.4	3.9

Note: Figures in parentheses represent percent shares of trade (exports-imports). Totals may not equal 100 percent due to rounding. Calendar years.

Source: Department of Commerce.

TABLE 10.—*United States Trade and Balance by Major Product Category*
[January–June 1976]

	Exports (US $ Billions)	Imports (US $ Billions)	Trade Balance (US $ Billions)
Total	55.6	56.6	– 1.0
Agricultural	11.2	5.4	5.8
NonAgricultural	44.3	51.2	– 6.9
Manufactures	37.3	30.5	6.8
Fuels	2.1	15.3	–13.2
Other	4.9	5.4	– 0.5

Note: Data seasonally adjusted, imports, FAS volume.
Source: Department of Commerce.

INTERNATIONAL TRADE FINANCE DEVELOPMENTS

Fiscal year 1976 saw significant changes in government-supported national export credit programs with two such changes being warmly endorsed by the National Advisory Council and its member agencies. First, the Export-Import Bank of the United States (Eximbank) announced a new range of interest rate charges which brought the cost of Eximbank loans closer to those available commercially. Second, after many months of discussion among governments and national export credit agencies in several other countries, the United States, on June 9, 1976, declared its support for the principle of cooperation to reduce competition in government-supported export credits. To implement this policy objective, Eximbank simultaneously announced more stringent export credit standards with the expectation that similar standards would be applied by other national export credit agencies abroad.

Export Credit Programs

On September 10, 1975, Eximbank announced a new interest rate schedule to improve the Bank's future earnings potential and, with a more substantial earnings base, to enable Bank to lower its interest rate, where necessary in individual cases, to meet proven foreign competition. The interest rate on Eximbank loans to finance exports of United States goods and services is 8.25 percent per annum for loans with a repayment term of less than six years from date of authorization. Rates increase 0.25 percent for each additional two years of maturity up to 9.5 percent on loans repayable in excess of fourteen years from the date of authorization. The Bank will continue its past standard practice of direct credit participation in the general range of 30 to 45 percent of the price of an export but will consider increasing its loan participation, through a combination of direct credits and financial guarantees, to as high as 85 percent to meet competition.

During fiscal year 1976 average interest rates on officially-supported export credits from France, Japan and the United Kingdom were typically lower than those in the United States. The United Kingdom's Export Credits Guarantee Department (ECGD) subsidized two to five-year credits at rates of from 7 percent to 8.5 percent while credits in excess of five years were supported at rates in the range of from 7.5 to 9.0 percent. The typical ECGD interest rate during fiscal year 1975 had been 8 percent. The French short-term rate was as low as 6.3 percent and the long-term rate was 7.5 percent. Both France and the United Kingdom typically cover 80 to 85 percent of the value of export transactions. The Export-Import Bank of Japan (JEIB) finances exports at rates ranging from 6.0 to 9.0 percent with most credits at 7.5 percent. JEIB will cover up to 64 percent of export value although coverage often is limited to 48 percent.

A comparison of these national rates, plus industrial bond yields is contained in Table 11.

The OECD Export Credits Group

The OECD Group on Export Credits (ECG) is a forum for governments to discuss various aspects of official export credit programs, such as reducing competition on official export credits, establishing minimum cash payments and maximum terms and conditions for credits covering certain categories of exports, and for exchanging information on official export credit policies in general and, in some instances, for particular transactions, in order to minimize counterproductive government-supported competition. During fiscal year 1976 the National Advisory Council continued to coordinate the United States Government position for the meetings of the ECG.

One major topic discussed by the ECG during fiscal year 1976 was the possibility for expanding the existing exchange of information system (which had been limited to exchanges of data on cash payments and repayment periods) to include data on financial charges, including interest rates on particular transactions. The United States sought inclusion of this information so as to enable exporting countries to make informed decisions based on the facts of foreign official credit competition, rather than allegations of such competition, as often occurs in the

TABLE 11.—*Comparative Export Financing Interest Rates 1973–1976*
[Percent, end of June]

	1973	1974	1975	1976
Country Export Financing Rates:				
Eximbank Rate*	6	7	7.0–9.0	8.25–9.50
United Kingdom	6	6–8.5	7.0–8.5	7.00–9.00
France	5.95–6.50	6.15–6.75	6.3–7.5	6.30–7.50
Germany	7.25	8.75	6.0–8.25	5.00–8.50
Italy	6.5	6.5	8.0–9.5	8.00–9.00
Japan	4–7	5.5–8.5	6.0–9.0	6.00–9.00
Industrial Bond Yields:				
United States	7.90	9.10	8.75	8.64
United Kingdom	10.79	16.83	15.98	14.62
France	8.87	11.93	10.93	10.86
Germany	9.42	10.89	8.52	8.05
Italy	8.56	13.57	16.18	15.82
Japan	7.57	11.61	9.10	8.78

*Long-term only. Rates for other countries include both medium- and long-term rates.

absence of good information. While the participating countries were unable to agree on formalizing these information exchange procedures, many OECD countries now exchange such information on an informal basis.

Unilateral Declarations on Export Credit

At the conclusion of the Rambouillet Conference in November 1975, the Heads of State and Governments of France, Germany, Italy, Japan, the United Kingdom and the United States declared that their Governments would intensify efforts to achieve a prompt conclusion of the discussions then underway among themselves and Canada concerning export credit. Consequent renewed discussions among these governments produced a consensus that counterproductive export credit competition must be avoided with respect to government-supported export credits. While it was not possible to reach a formal agreement to implement this consensus, the countries unilaterally undertook to establish guidelines, including minimum interest rates and maximum terms for official export credits for most export sectors.

By a declaration on June 9, 1976, the United States Government stated its policy fully to support the principle of cooperation in the field of officially-supported export credits in order to reduce counterproductive competition in government-supported export credits. A separate declaration by Eximbank sets forth the guidelines the Bank will observe for Eximbank supported credits for civilian goods and services.

According to its declaration, Eximbank will apply the following measures to export credits (including leasing) on a trial basis for the period July 1, 1976 to June 30, 1977:

(1.) Cash payments will be a minimum of 15 percent of the export contract value.

(2.) Eximbank interest rates will continue as at present, ranging from 8.25 percent to 9.50 percent on direct loans with flexibility to meet competition in certain transactions. However, the minimum blended competitive interest rates will not be less than 8 percent for credits over five years to highly developed countries, 7.75 percent for credits to intermediate countries, and 7.50 percent for credits to the less developed countries as measured by per capita Gross National Product. For two-to-five year credits, the minimum blended interest rates will be 7.75 percent to highly developed countries and 7.25 percent to all other countries.

(3.) Maximum repayment terms will be 10 years to less developed countries and 8.5 years to other countries. When credit authorizations to highly developed countries have repayment terms of more than five years, information will be given seven days in advance to other national export financing agencies.

(4.) If Eximbank intends to exceed the guidelines described above, it will so inform the other national agencies seven days in advance, with an additional nine days allowed for discussion, upon request. In addition, prompt information will be exchanged: (a) where credits are entered into under previously existing commitments; and (b) where credit terms have been set to meet the terms offered by other countries.

(5.) These guidelines will not apply to agricultural commodities, aircraft (including helicopters), and nuclear power plants. The guidelines for cash payments and maturities will not apply to satellite ground stations. Additionally, conventional power plants and steel mills will be exempt from maturity guidelines up to maximum present practices, with seven days advance information to other countries for transactions exceeding five-year repayment terms to highly developed countries, 8.5 years to intermediate countries, and 10 years to less developed countries.

(6.) Any credit having a grant element of 25 percent or more of the value of the goods and services exported, as already defined by the Development Assistance Committee of the OECD, is exempt from the guidelines. Any mixed credit having a grant element of less than 15 percent would result in seven days advance information. Credits having a grant element of at least 15 percent but less than 25 percent would result in prompt information exchange.

The Governments of the United Kingdom, France, Germany, Italy, Canada and Japan subsequently issued their own declarations or instituted internal procedures to establish guidelines not more favorable than those of Eximbank.

These guidelines are designed to bring official export financing practices closer to those standards determined by the market and thereby reduce the concessional element derived from government support. This will allow exporters to compete in world markets on such bases as price, quality and servicing of a product rather than on the basis of artificial incentives which can only be a burden to taxpayers.

The unilateral declarations issued by the United States Government, Eximbank and other governments reflect a spirit of cooperation in the field of publicly-supported export credits rather than a formal agreement, *per se*.

EXPORT-IMPORT BANK ACTIVITIES DURING FISCAL YEAR 1976

During fiscal year 1976 Eximbank authorized $8.6 billion in loans, guarantees and insurance to support $12 billion of United States exports. Overall activity increased 3.6 percent compared to the previous fiscal year. Of total authorizations, 40 percent was in commitments to disburse Eximbank funds (See Table 12). Loans authorized during this fiscal year carried an average interest rate of 8.45 percent, compared to an average cost of funds of 7.9 percent.

Average interest expense on Eximbank's total outstanding borrowings during the fiscal year was

TABLE 12.—*Summary of Eximbank Authorizations Fiscal Years 1973–1976*
[Millions of dollars]

	1973	1974	1975	1976
Loans	$4,053	$4,905	$3,812	$3,468
Guarantees	1,988	1,594	1,574	1,622
Insurance	2,473	2,601	2,929	3,527
Total	$8,514	$9,100	$8,315	$8,617

7 percent, while average interest income (excluding commitment and guarantee fees) was 6.05 percent. Thus, the average interest spread improved from minus 1.4 percent in fiscal year 1975 to minus 0.9 percent in fiscal year 1976. In fiscal year 1976 Eximbank earned a net profit of $117 million on gross revenues of $650 million and declared a dividend of $20 million payable to the United States Treasury. This compares with a net profit of $80.5 million on gross revenues of $545.8 million and a dividend of $20 million in fiscal year 1975. During fiscal year 1976 Eximbank borrowed $2,285 million from the Federal Financing Bank on terms of from two to eight years at an average interest rate of 7.9 percent.

COMMODITY CREDIT CORPORATION (CCC) EXPORT CREDIT SALES PROGRAM DURING FISCAL YEAR 1976

Agricultural exports under the CCC Export Credit Sales Program for fiscal year 1976 (including the first month of the Transition Quarter ending August 6), totaled approximately $740 million, as compared with $249 million in fiscal year 1975. The major users of CCC credit were Korea ($220 million), Poland ($122 million), Indonesia ($45 million), Pakistan ($44 million), Peru ($42 million), and Philippines ($35 million). Of the $740 million total, approximately $132 million represented financing on 12-month repayment terms and $608 million on 36-month terms.

CCC program activities were accelerated during fiscal year 1976 because of increased supplies of United States agricultural products and, on June 30, 1976, the list of commodities eligible for CCC export financing was substantially larger than a year earlier, comprising: barley, beef and dairy breeding cattle, breeding swine, corn, cotton, cottonseed oil, dry edible beans, dry edible peas, eggs (dried, frozen and canned), grain sorghum, hog grease, nonfat dry milk, oats, peanut oil, poultry (canned and frozen), raisins, milled and brown rice, soybeans, soybean meal, soybean oil, edible soy-protein, sunflowerseed oil, tallow, tobacco, wheat and wheat flour.

In fiscal year 1976, CCC credit lines were established for 33 countries (*vs.* 18 countries in fiscal year 1975). Credit extended during fiscal year 1975 amounted to nearly $487 million. This expanded to approximately $893 million in fiscal year 1976, part of it for shipment in subsequent periods.

CCC interest rates, which are reviewed by the National Advisory Council, were set, in fiscal year 1975, at 8 percent for United States bank obligations and 9 percent for foreign bank obligations. These rates, which continued through fiscal 1976, were higher than the cost of money to the CCC so that the CCC Export Credit Sales Program did not constitute a financial burden to the Government.

The CCC Export Credit Sales Program is a commercial, rather than a foreign assistance program which helps finance exports of eligible United States-produced agricultural commodities by the purchase of private exporters' accounts receivable. For all transactions there is required an irrevocable commercial letter of credit from an acceptable American or foreign bank authorizing the CCC to issue drafts against the letters of credit when payment is due. As a general rule, the foreign bank issues the letter of credit which must be fully advised by an American bank and confirmed for at least 10 percent for the commercial risks. If a United States bank, or one of its branches in a foreign country, issues the letter of credit it is liable for the political, as well as the commercial, risks on the full amount of the value financed for export.

On those requests to the CCC for credit from either foreign importers or United States exporters, when the amount to be financed is covered by a foreign bank letter of credit, and the financing period is longer than 12 months and the amount involved exceeds $4 million, the Department of Agriculture seeks the concurrence of the National Advisory Council. If the amount to be financed is covered by an American bank-issued letter of credit, NAC concurrence is not sought. Likewise, if a foreign bank obligation covers the amount to be financed and each transaction involves not more than $4 million and the financing period is no longer than one year, NAC concurrence is not sought.

ACTIVITIES UNDER THE PUBLIC LAW 480 PROGRAM DURING FISCAL YEAR 1976

Public Law 480 (P.L. 480) programming activity for fiscal year 1976 incorporated transition quarter (TQ) budget resources. Not all of the programming planned for the 15-month period was, however, completed during the fiscal year. The data in tables M–1 and M–2 of the Statistical Appendix of this Report represent agreement actions signed during the 12-month fiscal year ended June 30, 1976.

Commodity programming under Title I of P.L. 480 during fiscal year 1976 totalled $913.9 million for 5.1 million metric tons of commodities, compared with programming in fiscal year 1975 of $972.2 million for 3.6 million metric tons of commodities. These data indicate significant cost reductions in the commodity exports financed under Title I programs. In fiscal year 1976 convertible local currency agreements comprised 63 percent of the total value of agreements signed; dollar credit agreements comprised the remainder. In terms of dollar value, the six countries for which the largest amounts were programmed during the fiscal year were Egypt, Bangladesh, Korea, Pakistan, India and Indonesia. Programming to Egypt represented about 22 percent ($202.9 million) of the total; Bangladesh, about 18 percent ($164.6 million); Korea, 13 percent ($122.9 million); Pakistan, 9 percent ($91.3 million); India, 9 percent ($83.0 million); and Indonesia, 6 percent ($59.6 million).

Public Law 480 programming in fiscal year 1976 concentrated primarily on wheat and rice. Wheat was the major commodity programmed under Title I, and accounted for 62 percent of the total value and 78 percent of the total quantity programmed ($564.0 million and 4.0 million tons). Rice, at $211.0 million and 759,200 tons, accounted for 21 percent of the total value and 14 percent of the total quantity programmed. Among the nonfood commodities, programming for cotton declined from 254,000 bales in fiscal year 1975 to 90,000 bales in fiscal year 1976 while the quantity of tobacco programmed declined from 7,120 metric tons in fiscal year 1975 to 5,400 metric tons.

Under the Title II (donations) program, commodity quantities shipped during the fiscal year amounted to 873,650 metric tons (985,669 million tons/grain equivalent) valued at $313.7 million, the major commodities shipped being wheat, wheat products, and feedgrains. Wheat accounted for 112,702 metric tons, while bulgur, wheat flour and wheat soy blend accounted for 370,134 metric tons, wheat equivalency. Feedgrains, which were programmed only for human consumption, comprised 61,498 metric tons of corn and grain sorghum, while cornmeal and fortified food products such as corn soya milk, corn soy blend, soy fortified sorghum grits and whey soy beverage powder accounted for 307,156 metric tons, feedgrain equivalency.

Title II shipments of vegetable oil amounted to 109.1 million pounds (49,465 metric tons), of which the main component was peanut oil. The Office of Management and Budget also approved the use of 100 million pounds of CCC-owned nonfat dry milk. Of that amount 64.4 million pounds was shipped during the fiscal year. Dry edible beans were also made available under Title II during the fiscal year because of an abundant supply situation. During the period, edible dry beans were used to assist earthquake victims in Guatemala.

Fiscal year 1976 witnessed a continuation of the trend of increasing public interest in Public Law 480 programs, as attention focused on the problems of hunger and malnutrition in the developing countries. The trend toward emphasizing food aid programming was also reinforced (in December 1975) when Congress passed the International Development and Food Assistance Act of 1975 (approved by the President on December 20, 1975 (Public Law 94–161)). A major amendment to P.L. 480 effected by this the Act requires that at least 75 percent of Title I concessional credit food quantities be programmed for countries having an annual per capita gross national product of the equivalent of $300 or less. Another amendment authorizes the President to forgive indebtedness selectively on Title I sales programs to the extent an authorized recipient country uses sales proceeds generated by in-country sales of Title I commodities for agreed-upon specific self-help development projects. Such uses are to be considered payment of the dollar obligation to the United States Government, within the limit that the total value of such payments may not exceed 15 percent of the total value of all agreements entered into under Title I for a fiscal year. At the close of the fiscal year, procedures for implementing this provision were being developed.

Public Law 94–161 also established a minimum volume of Title II food assistance of 1.3 million metric tons, on a grain equivalent basis, of which a minimum of 1 million metric tons would be made available through nonprofit voluntary agencies and the World Food Program.

VI. FOREIGN INVESTMENT POLICIES AND ISSUES

- During fiscal year 1976 the net outflow of private long-term capital from the United States amounted to $9.7 billion, about $3.0 billion less than the net outflow of private long-term capital from the United States recorded in the preceding fiscal year.
- Investments by foreign official agencies in American corporate stocks and debt securities of private corporations and state and local governments amounted to $3.3 billion in fiscal year 1976 and foreign purchases of longer-term marketable United States Treasury securities also rose, with the oil producing countries purchasing $3.1 billion of such securities during fiscal year 1976.
- The Treasury and Commerce Departments completed bench-mark studies of foreign portfolio and direct investment in the United States during fiscal year 1976.
- Member countries of the Organization for Economic Cooperation and Development (OECD) including the United States, adopted a Declaration on International Investment and Multinational Enterprises which should contribute significantly to an open and stable environment for international investment.
- An intensive review of United States policy with regard to expropriation cases, designed to improve the implementation and the effectiveness of this policy, was completed during fiscal year 1976. Unresolved cases involving expropriated American-owned property abroad are also under continuing review.

FOREIGN INVESTMENT FLOWS

Private long-term capital movements to and from the United States in fiscal year 1976 resulted in a net outflow of $9.7 billion, or about $3.0 billion less than the net outflow recorded for the preceding fiscal year but still substantially above the $106 million net outflow in fiscal year 1974.

The outflow of United States direct investment abroad declined sharply in fiscal year 1976, with total outflows of about $3.8 billion, or about 58 percent lower than the historical high level recorded in the previous fiscal year. Despite this sharp decline, such outflows were still substantial and exceeded the amounts recorded in six of the past ten years. Factors which had contributed to the record outflow in fiscal year 1975 included increased working capital requirements necessitated by inflation and the termination of mandatory United States controls on direct investment abroad. The decline in fiscal year 1976 was attributable, in part, to reduced expansion plans caused by the economic slump in many of the major industrial countries. Capital expenditures by majority-owned American affiliates abroad are estimated, for example, to have increased by only 4.7 percent in calendar year 1975 as compared to 23 to 25 percent in each of the preceding two calendar years. Such capital outlays are projected to increase by only 0.3 percent in calendar year 1976.

About 60 percent, or $2,262 million, of the United States direct investment outflow went to Western Europe in fiscal 1976 with about 72 percent of this amount ($1,627 million) going to the United Kingdom. Canada, the country in which the United States foreign direct investment position is largest, received only $91 million of the outflow. During the last quarter of fiscal year 1976, there was, in fact, $181 million of disinvestment in Canada by American business.

A $725 million outflow in the third quarter of the fiscal year constrained foreign direct investment in fiscal year 1976 to a modest increase over fiscal year 1975. This outflow reflected payment of previously accumulated dividends owed to the government of a Middle Eastern country on its equity participation in a petroleum company incorporated in the United States. The previous accumulation of these dividends had been treated as a buildup of foreign direct investment in this country in the United States balance of payments accounts.

United States purchases of foreign securities continued to rise sharply as foreign borrowers placed record amounts of new bond issues in response to favorable credit market conditions in the United States. Canada was a particularly heavy borrower, accounting for nearly 56 percent of the fiscal year 1976 total. Borrowing by international financial institutions (the World Bank, the Asian Development Bank and the Inter-American Development Bank) accounted for another 20 percent.

Foreign purchases of United States securities, other than Treasury issues, increased sharply in fiscal year 1976. Increased purchases of American stocks, particularly by Western European countries, as the United States stock market advanced strongly accounted for much of this increase.

OTHER CAPITAL MARKET ACTIVITY

The foregoing data exclude investments by foreign official agencies and therefore exclude a portion of foreign investment in the United States through capital markets. Foreign official agency investments in United States securities have grown substantially in recent years. Net transactions in United States securities other than Treasury bonds and notes by these foreign official agencies have changed from net sales (outflow) of $495 million in fiscal year 1974 to net purchases (inflow) of nearly $3.4 billion in fiscal year 1976. (See Table 13.)

Foreign official purchases of longer-term marketable United States Treasury securities also increased during this period, largely because of OPEC purchases. In fiscal year 1976, the oil-producing countries purchased $3.1 billion of such securities. Despite the rapid increase, these capital inflows still represent a relatively modest proportion of the investable surplus funds accumulated by the oil-producing countries during this period.

The investment of OPEC funds in these longer-term investments is a reflection of the increasing economic sophistication of the oil producers as they diversify investments away from short-term bank deposits and Treasury bills in order to obtain higher long-term returns.

UNITED STATES INVESTMENT POLICIES AND OBJECTIVES

Any consideration of United States foreign investment policy must be made in the context of overall efforts to promote the free functioning of the market system. United States foreign investment policies, therefore, should be consistent with our efforts to liberalize trade and monetary arrangements throughout the world.

This policy is based on the premise that capital is a scarce resource and the free market should be relied upon as the most efficient means of determining the international allocation and use of capital. The United States position regarding foreign investment is to support the free flow of capital across international boundaries. If this flow is to function to the maximum benefit of all countries, it must remain, insofar as possible, undistorted by artificial impediments and incentives.

Accordingly, in efforts to liberalize the framework for international investment the U.S. has formulated its policy on the basis of the following principles: (1) restraints should not be imposed on the entry of foreign investment; (2) foreign investors should be given national treatment, i.e., should be treated no less favorably than domestic investors once they are operating in the host country; (3) investors should not be subject to special restraints or inducements by foreign governments; and, (4) disputes which arise among governments in particular cases should be settled in accordance with international law pursuant to agreed and fair procedures.

STUDIES OF FOREIGN INVESTMENT IN THE UNITED STATES

In May 1976 the Treasury and Commerce Departments had substantially completed their respective studies of foreign portfolio and direct investment in the United States and the results of these studies were reported to Congress in ac-

TABLE 13.—*Selected Long-Term Capital Flows**
[Millions of dollars]

	Fiscal Years 1974	1975	1976
Net Long-term Private Capital Flows	− 106	−12,741	−9,742
1. U.S. Direct Investment Abroad	−4,148	− 8,975	−3,758
2. Foreign Direct Investment in the U.S.	4,722	980	1,000
3. Foreign Securities	−1,513	− 3,888	−7,272
4. U.S. Securities other than Treasury Issues	2,910	31	2,936
5. Other, Reported by U.S. Banks	−1,267	− 1,399	−2,139
6. Other, Reported by U.S. Non-Banking Concerns	− 749	358	−1,200
7. Purchases of Marketable Treasury Bonds and Notes by Foreigners other than Foreign Official Reserve Agencies	− 61	152	728
Foreign Official Purchases of Marketable Treasury Bonds and Notes	−1,921	1,126	3,028
Foreign Official Purchases of Other U.S. Securities	− 495	2,546	3,363

* A positive number represents a capital inflow and a negative number a capital outflow.
Source: Department of Commerce.

cordance with the provisions of the Foreign Investment Study Act of 1974. These studies are benchmark statistical surveys, analyses and research into various aspects of foreign direct and portfolio investment in the United States. The two Departments submitted their respective final reports later in the year.

The Treasury Department study covered foreign portfolio investment—defined as foreign holdings of voting and non-voting stocks of American companies with assets of more than $1 million where such holdings do not give a foreign investor 10 percent or more of the ownership of a company, and in debt instruments with maturities of more than one year. The highlights of the Treasury study are as follows:

(1.) Foreign portfolio investment in the United States at the end of 1974, including both private and official holdings, totalled $67 billion.

(2.) Of this, $25 billion consisted of stocks and $42 billion of debt of American businesses and government entities (with corporate bonds accounting for $8 billion of the latter).

(3.) Foreign official institutions accounted for $27 billion of the total, the bulk of which ($25 billion) consisted of United States Government debt; foreign private investors accounted for corporate stocks valued at nearly $24 billion and debt worth $16 billion.

(4.) By country, 57 percent, or $22.8 billion of the total was held in Canada, the United Kingdom, and Switzerland, with France, Germany, and the Netherlands accounting for another 20 percent. The Middle East oil exporting countries held only $2.0 billion worth of the total (although such holdings increased substantially after 1974).

(5.) More than half of the foreign private holdings of United States stocks were reported in the name of "banks, brokers and nominees."

The analytical portion of the Treasury Department study focused on economic and institutional factors of foreign portfolio investment—the reasons foreigners invest in the United States, the economic influences behind their decisions, and the channels used to effectuate such investments; the effects of portfolio investment on the United States economy, including the balance of payments, investment position, and United States financial markets; legal aspects of investments; the adequacy of programs for collecting data; and the implications of the data for portfolio investment in the future. A significant conclusion of this phase of the Treasury study was that current reporting systems are adequate to provide accurate information on foreign portfolio investment in the United States.

The Commerce Department was responsible for the study on foreign direct investment in the United States. For purposes of this study such investment was defined as foreign ownership of 10 percent or more of the voting shares of a United States firm, or the equivalent interest in an unincorporated enterprise. The data from the benchmark survey were based on reports on more than ten thousand American legal entities. The principal findings of this portion of the study are as follows:

(1.) The foreign direct investment position in the United States was $26.5 billion at the end of calendar year 1974.

(2.) The United Kingdom, Canada, and the Netherlands each accounted for about one-fifth of the total; the 7 percent share of the Middle Eastern countries was almost entirely due to one government's participation in a petroleum company incorporated in the United States with operating assets in that country.

(3.) The major industries in which such investment was concentrated were: manufacturing (33 percent) petroleum (25 percent); and finance, insurance and real estate (25 percent).

(4.) The total assets of all United States affiliates of foreign enterprises amounted to $174.3 billion at year-end 1974.

The findings of the analytical phase of the Commerce Department study were presented in volumes one and two of its report to Congress and in seven volumes of appendices. The topics discussed include such aspects of foreign direct investment in the United States as the reasons why foreigners invest here; industrial and geographical concentrations of foreign investments; management, labor, and accounting practices; taxation issues; policies, laws, and regulations of the United States and of other countries on inward investment; and economic effects. The major conclusion of the study was that the findings did not warrant any change in existing policy, but that the data-gathering and analytical responsibilities focused in the Commerce Department should be strengthened, including the requisite legislative authority.

The Treasury Department study was the first of its type effected since 1941; the last study of foreign direct investment in the United States—a benchmark statistical survey—had been conducted in 1959. The statistical data derived from both studies will be used to update data from the United States Government's on-going programs for monitoring current transactions in the investment area.

As indicated in last year's Annual Report of the National Advisory Council, the Executive Branch in 1975 conducted a review of overall policy with respect to foreign investment in the United States and decided to implement a number of new administrative arrangements in this area. During fiscal year 1976 substantial progress was made in putting these arrangements into operation.

One of these measures was the establishment of the interagency Committee on Foreign Investment in the United States to monitor and coordinate the formulation of policy on foreign investment in the United States. Among the more important issues this Committee has taken up are several proposed investments which it considered pursuant to its specific responsibility for reviewing foreign investments in the United States which might have major implications for our national interests. These investment proposals included the joint venture of the Government of Romania and the Island Creek Coal Company (a subsidary of the Occidental Petroleum Corporation); the attempt by Societe Imetal, a French firm, to take over Copperweld Corporation; and the proposed investment by the Government of Iran in the Occidental Petroleum Corporation. In each instance the Committee decided it had no objection to the proposed transaction. The Committee was also responsible for coordinating the positions of Executive Branch agencies for Congressional hearings on the International Investment Survey Act of 1976 (P.L. 94–472) which provided new and expanded authority for United States Government programs for collecting data on foreign investment, and discussed investment questions that have arisen in international negotiations.

A second initiative in the investment area was the announcement that the United States would expect all foreign governments contemplating significant foreign investments in this country to hold prior consultations with the United States Government. During the past fiscal year there were clear indications that other countries recognize our legitimate interests in this connection, and, in fact, consultations were held with the governments of the countries involved in each of the cases the Committee on Foreign Investment in the United States has reviewed.

The third measure, creation of an Office of Foreign Investment in the United States in the Department of Commerce, has also been implemented. This Office monitors individual foreign investments and analyzes the impact of foreign investments on the American economy and on significant industrial sectors. As part of its monitoring program the Office of Foreign Investment obtains and consolidates data collected by many agencies of the United States Government.

INTERNATIONAL ASPECTS OF INVESTMENT POLICY

On June 21, 1976, the Member Governments of the Organization for Economic Cooperation and Development (OECD), except Turkey, jointly adopted a Declaration on International Investment and Multinational Enterprises which should contribute significantly to an open and stable environment for international investment.

These countries acted in recognition of the fact that all countries benefit from a liberal climate for international investment flows among industrial countries, and that the maintenance of such an environment is, and will continue to be important to world economic well-being in the future.

The OECD Declaration addresses three areas of concern regarding international investment. First, the Member countries declare they should treat foreign investors no less favorably than domestic enterprises in similar circumstances. Second, the countries agree to take into account possible damage to other Member countries should they provide official incentives or disincentives to foreign direct investment. Finally, the countries recommend voluntary guidelines for the behavior of multinational enterprises (MNEs), including provisions on the relationships to be expected with host governments and domestically-owned enterprises, expectations regarding information, disclosure of financing, competitive practices, taxation, employment and industrial relations, and the transfer of technology. The countries also stated their general responsibilities toward multinational enterprises (for instance, to treat these in accordance with international law).

These measures constitute concrete steps to ensure that the freedom and openness of the environment the OECD countries have established for foreign investors will be maintained and strengthened. As the OECD countries have done in the trade and monetary fields, so in the investment field they have reaffirmed the principle that goods and capital should be able to move in international commerce in accordance with the direction of free market forces.

An important objective of the Guidelines for Multinational Enterprises is to counter the erosion of public confidence in multinational enterprises stemming from revelations concerning questionable payments and charges that multinational enterprises operate beyond the sovereign control of national governments. The OECD Member Governments hope, by these Guidelines, to improve the investment climate and to preserve the benefits derived from the activities of multinational enterprises.

The Guidelines respond to the conditions the United States has indicated such a statement of principles must embody: they (1) are voluntary, (2) do not discriminate against multinational enterprises and in favor of host country enterprises, (3) are in accord with existing principles of international law, (4) apply to State-owned as well as privately-owned enterprises, and (5) set forth the responsibilities of governments to foreign enterprises operating within their territories.

The groundwork has also been laid in the United Nations for discussion of a code of conduct dealing with MNEs in the Commission on Transnational Corporations. At its second meeting in Lima, Peru in March 1976, this Commission agreed that the formulation of the code should be given the highest priority among the tasks in its work program. To this end, an intergovernmental working group will begin, early in 1977, to work on an annotated outline to serve as a basis for discussion of the proposed code.

Other tasks the Commission on Transnational Corporations will undertake include: (1) establishment of a comprehensive information system; (2) research on the political, economic, and social effects of the operations and practices of MNEs; (3) organization of a technical cooperation program; and (4) analysis leading to a definition of MNEs.

PRESIDENT'S TASK FORCE ON QUESTIONABLE CORPORATE PAYMENTS ABROAD

During fiscal year 1976, in response to disclosures of bribery by American firms abroad, the United States took a number of steps to deal with the problem of illicit payments in international commerce. On the domestic side, a number of United States Government agencies initiated efforts to deal with this problem within their respective jurisdictions. The Internal Revenue Service, for example, intensified efforts to uncover instances of tax avoidance and evasion by American corporations through improper deductions of bribes and other illicit payments. The Securities and Exchange Commission has also been quite active, bringing court actions against publicly-held corporations alleged to have omitted or misstated material information in periodic reports filed with the Commission.

The Unted States also took a number of initiatives in international forums designed to stimulate international action to curb illicit payments. First, at the suggestion of the United States, a provision on bribery and illegal political contributions was inserted in the OECD Guidelines for MNEs. Second, the United States proposed, at a meeting of the UN Commission on Transnational Corporations in March 1976, that an agreement be negotiated within the United Nations to curb illicit payments. Subsequently, the United Nations Economic and Social Council (ECOSOC) agreed to create an intergovernmental working group to examine this problem and to elaborate such an international agreement for presentation to the ECOSOC in 1977. Finally, in response to a Senate resolution, the United States Government urged our trading partners to make an international code of conduct on business practices a goal of the Multilateral Trade Negotiations being conducted under the General Agreement on Tariffs and Trade.

In March 1976 the President established a Cabinet-level Task Force on Questionable Corporate Payments Abroad to conduct a coordinated review of these activities and to recommend any new actions it might consider necessary. In August 1976 the President sent to Congress a proposal for legislation this Task Force had formulated which would require reporting and disclosing of certain payments made by American corporations in connection with business with foreign governments. The Congress did not act on this proposed legislation before adjourning.

UNITED STATES EXPROPRIATION POLICY

The Administration remains concerned over investment disputes and expropriations involving American property abroad. Foreign countries have become increasingly sophisticated in using techniques short of expropriation (such as forced buy-outs or "indigenization" programs, discriminatory or confiscatory taxes, and cancellation or forced revision of contracts or concession agreements) to achieve many of the same results as formal expropriation.

Important United States interests are affected by these events. Increased government intervention in the economies of developing countries means the private sector is less able to play an effective role in efficiently allocating resources. A poor investment climate in a particular country, because of expropriatory or discriminatory acts, can mean decreased capital flows for development. Expropriations without fair compensation may also mean burdens for the United States taxpayer or consumer, as well as the affected firm.

The basic elements of our policy on expropriation were most recently reiterated in a 1972 Presidential Statement, which indicated that under international law, the United States has the right to expect that any taking of American property abroad will be nondiscriminatory, for a public purpose, and accompanied by payment of prompt, adequate and effective compensation.

The Hickenlooper Amendment to the Foreign Assistance Act of 1961, the Gonzalez Amendment to the legislation authorizing United States participation in the international development lending institutions, and the provisions of the 1974 Trade Act relating to the Generalized System of Preferences (GSP), also deny certain benefits to countries which expropriate American-owned property but fail to take reasonable steps toward providing prompt, adequate, and effective compensation.

In expropriation cases, the United States Government stands ready to assist in a number of ways to promote a negotiated settlement. The United States seeks the "good offices" of international development lending institutions to promote the settlement of investment disputes. In appropriate cases, the United States will use diplomatic channels to urge a foreign government to settle investment disputes promptly and in a mutually-satisfactory manner. In cases where there are violations of international law, the United States may take a public position on the pertinent principles of international law, and it stands ready to espouse or present formal diplomatic claims or to become actively involved in mediating or otherwise seeking to encourage resolution of investment disputes.

Because of this concern over investment disputes, the United States Government recently completed a review of our expropriation policy with a view toward improving its implementation and effectiveness. The CIEP Interagency Staff Coordinating Group on Expropriation has supported a capital increase for the International Finance Corporation, the presence of which may smooth the relations between foreign investors and host countries. It is examining the possibility of international conventions to expand the judicial remedies available to an owner of expropriated property. It has improved the procedures within the United States Government for disseminating and sharing information. It has also expanded contacts with the business community to assure that businessmen are aware of existing policies and procedures.

In connection with the implementation of GSP on January 1, 1976, the United States Government also conducted a particularly intensive review of outstanding investment disputes in all potential beneficiary developing countries under the expropriation provision (Sec. 502 (b) (4)) of the Trade Act of 1974. The United States Government continues to keep under active review all unresolved cases of expropriated American-owned property abroad.

A recent major expropriation in Peru is particularly noteworthy. At the request of the Peruvian Government and the American company, a

United States Government delegation reached a negotiated settlement with the Government of Peru. The President had named a personal representative to head the delegation for the purpose of negotiating a conclusion of this dispute that was fair to both the Government of Peru and the United States company. In this case, the United States delegation was able to develop and express independent views on the merits of the key issues, such as tax claims and valuation. The delegation was assisted in developing these independent views through access to information which the United States Government had gathered and assessed through its own resources and by commissioning an outside consultant to establish a reasonable range of values for the expropriated property. Therefore, the United States delegation was able to encourage both parties to exhibit greater flexibility and eventually was able to reach a settlement acceptable to both sides, which satisfied our rights under international law to receive prompt, adequate, and effective compensation when the property of an American investor is expropriated. The United States Government role in this case may provide a useful precedent for enabling the United States Government to play a constructive role in other appropriate expropriatory situations.

VII. POLICIES AND ISSUES IN FOREIGN INDEBTEDNESS

• The external public debt outstanding of eighty-six developing countries rose from $122 billion at the end of calendar year 1973 to $151 billion at the end of calendar 1974 (latest data available), reflecting the continuing economic and financial pressures being encountered by these countries.

• Debt problems of the developing countries were examined and discussed in several international forums during fiscal year 1976, including the United Nations Committee on Trade and Development (UNCTAD), the Conference on International Economic Cooperation (CIEC) and the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD/DAC).

• The United States Government continues to oppose proposals for a general debt rescheduling or a debt moratorium on grounds that these are not appropriate instruments for alleviating the balance of payments financing difficulties of developing countries.

• Proposals for debt reorganization are examined by the United States on a case-by-case basis in the institutional framework of the "creditor club" mechanism. In fiscal year 1976 the United States participated in only one multilateral debt rescheduling meeting, that for Zaire.

• The National Advisory Council continued its oversight of foreign indebtedness policies and problems during the fiscal year and helped coordinate the Administration's second annual report to the Congress on debt relief.

• As of December 31, 1975, total principal outstanding on post-World War II indebtedness of foreigners to the United States Government was $36.7 billion, of which $35.6 billion represented long-term credits and about 70 percent of which was owed by the non-oil exporting developing countries.

• Of the total principal amount outstanding on United States Government long-term foreign credits as of December 31, 1975 (excluding World War I debts), only about one percent was due and unpaid ninety days or more.

• During fiscal year 1976 a number of steps were taken to improve foreign debt reporting and collection procedures and efforts to eliminate overdue debt payments owed by foreigners to the United States Government were intensified.

DEBT OUTLOOK FOR THE DEVELOPING COUNTRIES

The economic prospects for most of the non-oil exporting developing countries were significantly impaired by the events of late 1973 and early 1974. The sharp increase in oil prices placed an immediate heavy burden on the balance of payments of these countries involving additional costs of $10 billion in direct payments for oil imports. Higher food and fertilizer prices in 1974 also had a serious adverse impact on the balance of payments situations of many developing countries, although prices for some of these goods tended to decline during the second half of calendar year 1975. In addition, sharp declines of other commodity prices, persisting inflationary pressures and recession in the industrialized world, reduced the export earnings of many developing countries.

In responding to these balance of payments difficulties, some developing countries have adopted restrictive monetary and fiscal policies to minimize their external payments deficits—albeit at the price of reduced economic growth. Other developing countries have attempted to maintain economic growth targets despite increasing balance of payments deficits. In order to help finance current account deficits and minimize the immediate adverse impact of world economic and financial pressures on development prospects, the non-oil exporting developing countries as a group increased external debt substantially. The major shifts in the world economic situation stimulated some concern over the increased level of external debt of the developing countries (and their ability to service this debt), but only one country, Zaire, sought the rescheduling of its external debt during fiscal year 1976.

External public debt outstanding (including undisbursed portions) of 86 developing countries rose from $122 billion at the end of calendar year

TABLE 14.—*External public debt outstanding of 86 developing countries as of December 31, 1974*
[$ Millions]

Region, country	Disbursed only	Including undisbursed: Total	Bilateral official	Multi-lateral	Suppliers	Banks	Other
Africa South of the Sahara—total	9,314.2	15,957.3	7,349.3	4,019.4	1,598.8	2,640.3	349.5
Benin, People's Republic of	82.4	232.8	178.3	33.8	4.8	14.8	1.1
Botswana	129.3	179.0	115.8	60.2	0.2	....	2.7
Burundi	8.0	21.3	2.4	11.5	4.5	....	2.8
Cameroon	299.8	570.1	263.1	217.9	8.6	80.5	....
Central African Republic	58.1	72.0	47.8	14.6	5.2	2.5	1.9
Chad	46.1	71.4	29.6	26.2	7.3	7.1	1.1
Congo, People's Republic of the	246.4	499.1	254.7	55.4	176.2	1.1	11.7
East African Community	251.0	359.2	100.8	202.9	12.0	....	43.5
Ethiopia	284.1	566.0	259.1	273.2	0.9	32.8	....
Gabon	427.4	439.1	84.7	35.2	101.6	169.3	48.3
Gambia, The	13.2	22.8	14.5	8.4	....	....	....
Ghana	606.4	684.4	364.9	117.6	201.9	....	....
Ivory Coast	736.7	1,213.2	305.0	246.1	289.7	310.0	62.4
Kenya	455.8	733.9	402.4	267.1	14.8	19.6	30.0
Lesotho	8.5	16.7	1.2	14.5	....	0.4	0.5
Liberia	168.6	211.6	139.2	48.5	10.9	12.0	1.0
Madagascar	133.0	232.2	98.5	121.4	3.7	4.6	4.0
Malawi	223.8	320.6	208.3	88.4	5.5	6.3	12.1
Mali	264.3	335.1	265.2	62.4	7.5	....	....
Mauritania	145.0	336.1	214.0	47.6	69.8	4.7	....
Mauritius	34.4	121.7	77.5	43.2	0.4	....	0.6
Niger	85.4	107.8	76.1	25.5	2.7	3.5	....
Nigeria	751.7	1,078.5	458.1	579.7	20.4	16.8	3.5
Rwanda	13.0	57.1	30.7	23.6	2.0	....	0.8
Senegal	239.0	408.1	184.5	99.7	17.0	79.0	23.0
Sierra Leone	117.3	146.3	50.8	34.1	58.3	....	3.0
Somalia	198.8	377.6	311.7	61.0	....	....	4.9
Sudan	356.6	1,051.2	418.5	247.3	46.5	338.9	....
Swaziland	39.1	57.8	37.2	18.5	2.1	....	....
Tanzania	575.1	1,096.3	768.7	295.6	0.1	13.0	18.9
Togo	91.8	190.8	113.6	24.2	15.0	32.9	5.1
Uganda	188.9	248.7	155.6	73.9	....	2.5	16.6
Upper Volta	46.0	147.1	100.9	45.3	0.9	....	....
Zaire	1,309.3	2,562.8	684.5	137.8	450.1	1,271.3	19.1
Zambia	679.7	1,188.7	531.4	357.0	58.1	216.5	25.7
East Asia and Pacific—total	14,145.8	23,761.8	10,982.0	4,661.6	3,421.1	3,584.6	1,112.4
China, Republic of	1,139.0	2,607.9	1,133.0	366.1	313.3	454.6	340.9
Fiji	41.3	66.3	25.0	24.9	1.2	....	15.3
Indonesia	5,897.3	8,696.0	5,644.2	900.0	1,280.1	477.4	394.3
Korea, Republic of	4,028.7	6,147.3	2,261.6	932.9	1,636.0	1,173.4	143.4
Malaysia	873.9	2,189.1	385.6	737.6	16.7	971.0	78.3

TABLE 14.—*External public debt outstanding of 86 developing countries as of December 31, 1974*—Continued

[$ Millions]

Region, country	Disbursed only	Including undisbursed: Total	Bilateral official	Multi-lateral	Suppliers	Banks	Other
Philippines	1,031.2	2,002.2	699.7	776.6	83.1	394.3	48.5
Singapore	476.8	639.0	232.7	237.2	62.6	33.0	73.4
South Viet-Nam	144.2	291.5	189.5	37.4	...	46.2	18.4
Thailand	513.4	1,122.6	410.8	648.9	28.2	34.7	...
Latin America and the Caribbean—Total	34,571.1	45,385.3	11,253.1	9,615.3	5,452.0	14,308.1	4,756.9
Argentina	3,345.0	4,863.7	1,040.5	774.7	1,237.8	1,130.6	680.1
Bolivia	708.4	894.6	445.2	138.8	52.9	91.9	165.8
Brazil	9,302.9	11,984.3	2,699.7	2,430.4	1,520.4	4,794.9	538.9
Chile	3,729.1	4,459.6	2,238.5	315.1	546.6	712.0	647.4
Colombia	2,104.2	2,750.3	1,015.1	1,152.1	209.3	272.7	101.1
Costa Rica	302.9	478.8	117.2	207.0	31.5	114.3	8.7
Dominican Republic	359.1	623.3	311.4	128.0	9.0	173.9	1.1
Ecuador	297.4	532.5	146.2	228.7	99.1	40.7	17.8
El Salvador	180.6	309.8	59.0	159.8	...	88.4	2.7
Guatemala	122.5	209.6	70.5	122.7	5.9	9.1	1.5
Guyana	203.4	322.7	189.4	41.4	2.9	32.0	57.1
Honduras	154.4	273.9	76.5	185.8	8.0	3.6	...
Jamaica	473.9	650.0	134.4	137.0	25.7	297.9	55.0
Mexico	8,013.8	9,766.2	992.6	2,220.6	335.7	4,205.0	2,012.4
Nicaragua	445.7	641.1	168.0	184.9	7.9	184.6	95.7
Panama	472.2	644.1	129.2	128.9	24.5	331.7	29.8
Paraguay	151.7	309.3	126.0	97.5	41.5	43.8	0.5
Peru	2,050.6	2,972.1	735.8	280.4	737.7	1,114.1	104.2
Trinidad and Tobago	171.3	227.5	35.2	93.2	7.0	82.6	9.5
Uruguay	514.1	615.6	239.2	142.1	87.0	126.8	20.5
Venezuela	1,467.9	1,856.3	283.7	446.1	461.6	457.6	207.3
North Africa and Middle East—Total	14,181.1	22,791.5	12,656.8	2,657.5	3,624.0	3,484.0	369.2
Afghanistan	771.6	1,596.3	1,515.0	74.9	6.5	...	...
Algeria	3,324.9	6,039.5	1,763.9	190.2	1,863.9	2,067.4	154.1
Cyprus	74.7	100.7	11.8	63.9	20.5	4.4	...
Egypt, Arab Republic of	1,811.0	3,119.5	2,364.0	277.5	128.1	255.5	94.5
Iran	5,134.8	6,604.4	3,793.9	935.8	994.3	800.9	79.5
Iraq	407.2	670.0	515.4	135.9	18.8	...	...
Jordan	286.4	546.0	468.1	50.0	17.6	10.2	...
Morocco	1,123.8	1,902.1	1,038.2	489.5	171.3	173.2	29.9
Syrian Arab Republic	290.7	769.1	309.2	136.7	295.1	28.0	...
Tunisia	956.0	1,443.8	877.5	303.0	107.8	144.3	11.3
South Asia—Total	17,466.5	23,383.8	16,058.7	6,149.4	994.6	174.3	6.7
Bangladesh	753.7	1,674.9	917.8	500.6	221.6	34.9	...
Burma	291.7	455.4	306.2	97.6	51.2	0.4	...
India	11,241.6	14,207.5	9,573.5	4,211.2	391.5	29.0	2.2
Pakistan	4,634.5	6,230.0	4,751.2	1,198.4	170.5	109.7	0.2
Sri Lanka	545.0	816.0	510.0	141.7	159.9	0.2	4.3
More advanced Mediterranean countries—total	15,850.1	20,119.7	8,467.6	3,134.5	1,137.1	4,500.2	2,880.3
Greece	2,026.1	2,733.0	386.5	248.8	222.9	1,709.9	165.0
Israel	5,562.1	5,894.8	2,546.0	183.9	190.6	649.5	2,324.8
Malta	26.9	32.9	27.5	3.1	...	2.3	...
Portugal	598.5	753.3	156.8	42.2	289.4	222.5	42.4
Spain	2,399.1	2,940.3	851.8	447.1	161.1	1,172.6	307.7
Turkey	3,104.7	4,306.2	2,778.9	1,293.5	129.3	87.0	17.5
Yugoslavia	2,132.8	3,459.3	1,720.2	915.9	143.9	656.5	22.9
Grand total	105,528.7	151,399.3	66,767.6	30,237.6	16,277.6	28,691.5	9,475.0

NOTES: External public debt is defined as debt repayable to external creditors in foreign currency, goods or services, with an original or extended maturity of more than one year, which is a direct obligation of, or has repayment guaranteed by, a public body in the borrowing country. Most military debts are not reported, although a few countries have included such obligations in their data. Items may not add to totals due to rounding.

Source: World Bank.

1973 to $151 billion at the end of calendar 1974 (latest year for which comprehensive data are available from the World Bank). The World Bank external debt tabulation is presented in Table 14.

Although precise data on the expansion of developing countries' external public debt since the end of calendar 1974 are not yet available and final figures on the 1975 current account balances of the non-oil developing countries are not complete, estimates and projections can serve to indicate the order of magnitude of the problem for 1975 and 1976. The combined current account deficit of the non-oil developing countries increased from $9 billion in calendar year 1973 to $27 billion in 1974, and to approximately $35 billion in calendar year 1975. Most of the non-oil developing countries substantially increased external borrowing in 1974 and 1975 to finance these current account deficits. For 1976, the aggregate current account deficit of these countries is estimated to have declined by about $8 billion, to about $27 billion, or roughly the same as in calendar year 1974.

It is normal for developing countries to be net importers of capital from a variety of sources including bilateral loans and grants, aid from multilateral institutions, private direct investment, private credits, and official trade credits. Some of these capital flows, such as aid grants and most direct investment, do not lead to increased debt servicing requirements and a substantial proportion of other capital flows consists of long-term credits from official sources at concessional rates of interest. Most of these credits also feature grace periods and will increase debt service by only modest amounts during the next few years. In 1974 and 1975, however, the non-oil developing countries borrowed extraordinarily large amounts from private lenders and these borrowings—on the order of $10–12 billion each year on a net basis—generally consisted of short- and medium-term credits at relatively high rates of interest which has led to a substantial increase in the debt servicing burden of these developing countries. At the same time, developing country borrowings from the IMF increased sharply and their reserves were drawn down during calendar year 1975 for the first time in more than a decade.

For calendar year 1976, the financing problem of the non-oil developing countries as a group will be less acute than it was in 1975. Current account deficits, while still high, are estimated to be about $8 billion lower and official capital flows are likely to increase by about $1 billion. As indicated in Chapter III of this Report, IMF resource availability has been expanded considerably by a temporary increase in member country access to regular IMF resources, the establishment of a Trust Fund to channel profits from IMF gold sales to the poorest countries and through the liberalization of the IMF Compensatory Financing Facility. Net drawings from the IMF by non-oil developing countries are expected to peak in calendar year 1976 at about $3 billion. These circumstances should permit a sharp reduction in net borrowing by the developing countries from private lenders as compared with the preceding two years. It is, however, possible that a relatively high level of private borrowing may persist as the non-oil developing countries seek to rebuild their foreign exchange reserve holdings.

INTERNATIONAL CONSIDERATION OF DEVELOPING COUNTRIES' DEBT

The debt problems of the developing countries continued to be the subject of active debate in several international forums during fiscal year 1976, including the Development Assistance Committee (DAC) of the OECD, the UNCTAD and the Conference on International Economic Cooperation (CIEC). The developing countries initiated proposals in UNCTAD and elsewhere to obtain relief from their debt obligations. As enunciated in the Manila Declaration of February 1976, the developing countries envisioned not only a moratorium on repayments owed by the least developed countries but also generalized debt relief for other developing countries. At the fourth session of UNCTAD in Nairobi in May 1976, major attention was given to the issue of a debt moratorium for the poorest developing countries and debt rescheduling for the other developing countries. The creditor countries, resisting and rejecting such demands for generalized debt relief, focused attention on the overall balance of payments situation of the non-oil developing countries and on ways of improving the traditional case-by-case approach to debt crisis situations.

A resolution relating to the debt problems of the developing countries was approved at the UNCTAD meeting. In this resolution, all countries agreed to invite "existing international fora to determine, before the end of 1976, what features might usefully be discerned from past (debt) operations, together with others that might be identified in the light of the present situation of the least developed countries, the most seriously affected developing countries and other countries in need, which could provide guidance in future operations relating to debt problems as a basis for dealing flexibly with individual cases."

It has been agreed that the Conference on International Economic Cooperation (CIEC) discussed earlier in this Report (Chapter II) is an appropriate locus for following up this UNCTAD resolution. The developed countries are coordinating their positions for CIEC in the Temporary Working Party of the OECD with the objective of devising a procedure for efficient and equitable treatment of debt situations on a case-by-case basis. Within the CIEC, the debt issue is being considered by the Financial Affairs Commission and also by the Development Commission in the context of a country's longer run balance of payments financing situation.

UNITED STATES POLICY ON DEBT RESCHEDULING

In international forums the United States Government has opposed a generalized debt rescheduling or debt moratorium, our view being that these are not appropriate instruments to alleviate the balance of payments financing difficulties of developing countries. The generalized rescheduling proposals already advanced have, in addition, serious shortcomings. A generalized rescheduling or moratorium would, for example, be inequitable since it would disregard both the need and performance of debtor countries. Moreover, the interests of the poorest countries would clearly be better served by focusing on improvements in the quality and quantity of new assistance. Generalized debt relief proposals would also tend to reduce the confidence of private lenders, thereby tending to raise the cost of subsequent borrowing by developing countries in the short run, and possibly adversely affecting the flow of resources to those countries over the longer run unless those countries achieve fundamental improvements in their financial situations.

The United States currently evaluates the merits of debt reorganization proposals on a case-by-case basis within the institutional framework of the "creditor club" mechanism. While not insensitive to the financing problems of many of the developing countries, the United States emphasizes that balance of payments difficulties should be dealt with through the adoption of appropriate domestic and external economic policies to eliminate the need for debt relief. The United States seeks to minimize the incidence of debt rescheduling and encourages the debtor country to undertake structural transformations in its economy so that future debt relief becomes unnecessary.

The United States does not reschedule debt as a means of bypassing normal budget and legislative processes for furnishing assistance to foreign countries. Although the United States is sympathetic to the need for accelerating the flow of resources to the developing countries, and particularly the poorest among them, it does not believe debt relief should be considered alone as a means of the resource transfer, but rather within the framework of broad-gauged solutions involving official assistance, improved access to capital markets, direct investment flows, and specific financial programs under the auspices of the IMF and the World Bank.

DEBT RESCHEDULING DURING FISCAL YEAR 1976

The developing countries have, as a general rule, an excellent record in honoring their foreign debt obligations. Despite the economic and financial upheavals of the last several years, debt rescheduling has been the exception rather than the rule and when used has, in any event, helped to ensure ultimate repayment by debtor countries. During fiscal year 1976, the United States participated in only one multilateral debt rescheduling meeting, for Zaire, and signed rescheduling agreements with Pakistan and Bangladesh implementing multilateral agreements reached in 1974.

Zaire

In recent years, Zaire's economic situation has been characterized by rapid price increases, substantial balance of payments deficits and a slowdown in the rate of economic growth. Since mid-1974, the economy of Zaire has been subject to a number of external and internal pressures which led to the development of a critical situation in 1975 and a subsequent need for debt rescheduling in 1976. Externally, the sharp decline in the world market price of copper (Zaire's major export) and the continuing increase of import prices led to a large trade deficit. Additional problems arose because of the closing of the Benguela railroad in Angola which is an important route for Zaire's export and import trade. On the domestic side, expansionary fiscal and credit policies increased aggregate demand at unsustainable rates and, with rapidly growing expenditures, government budget deficits further aggravated inflationary pressures.

In response to the inability of the Government of Zaire to meet its debt obligations, the "Paris Club" of creditor countries concluded an *ad referendum* debt rescheduling agreement in June 1976. Under the terms of this agreement, principal and interest falling due from January 1, 1975 to June 30, 1976 and not yet settled, as well as principal payments falling due during the second half of 1976 are to be rescheduled. Bilateral agreements between Zaire and the Paris Club member countries are to be negotiated to implement this rescheduling agreement.

Pakistan and Bangladesh

United States debt negotiations with Pakistan and Bangladesh were in response to the unique circumstances arising out of the 1971 war and the independence of Bangladesh. After the conclusion of hostilities Pakistan insisted that debts arising from programs of primary benefit to Bangladesh should be assumed by Bangladesh. Bangladesh affirmed its intention to assume responsibility for a portion of the external debt of the formerly united Pakistan, but only in the context of an overall financial settlement. In order to facilitate a final settlement, the Aid-to-Pakistan Consortium agreed to short-term debt reschedulings in 1972 and 1973. United States implementation of the 1973 understanding, under which the United States agreed to reschedule approximately $23 million of debt falling due between July 1973 and June 1974, is formalized in the present debt agreement.

In the June 1974 Memorandum of Understandng, the creditor countries agreed to provide debt relief to Pakistan in the amount of $650 million, to be provided over the succeeding four to five years. The creditor countries also agreed that the terms of this debt relief would include a grant element of no less than 62 percent. The bilateral agreement between the United States and Pakistan became effective in April 1976 and provides for the rescheduling of approximately $203 million of debt service falling due during the period from fiscal year 1975 to fiscal year 1979.

Directly related to this agreement with Pakistan is an agreement with the Government of Bangladesh for it to assume debt liability relating to projects "visibly located" in Bangladesh territory. In the bilateral agreement with Bangladesh, which became effective in April 1976, the United States is to reschedule $85 million in debt service obligations assumed by Bangladesh. The United States and other creditor countries have agreed that the loan obligations assumed by Bangladesh will be rescheduled on terms equivalent to a minimum of 84 percent grant element. Bangladesh will also assume responsibility for servicing $2.6 million of Export-Import Bank loans which will not be rescheduled.

ROLE OF THE NATIONAL ADVISORY COUNCIL

The National Advisory Council continued to review the debt problems of the developing countries during fiscal year 1976 and served as a coordinating body for United States Government positions on debt issues.

In October 1974 the National Advisory Council Alternates reviewed policy guidelines relating to the United States approach to debt rescheduling cases. At this meeting, the Council reaffirmed its view that there is a general presumption borrowing countries would repay loans extended by the United States according to the agreed repayment schedules and should be constrained to do so. It was further agreed that debt rescheduling should not be considered as an instrument for providing economic assistance to debtor countries.

During fiscal year 1976 the NAC served also as the coordinating body for reviewing the Administration's second annual *Report on Developing Countries' External Debt and Debt Relief Provided by the United States*. This report, called for by Section 634 (g) of the Foreign Assistance Act of 1961 as amended by the Foreign Assistance Act of 1973, was prepared by Treasury and transmitted to the Congress on January 30, 1976. It provided reviews on the debt situation of the developing countries as of December 1973, balance of payments trends in the non-oil developing countries for the period 1973 to 1976 and examines the implications of these trends for the developing countries' debt position. The Report also includes detailed information on recent debt servicing problems encountered by major debtor countries and the methods by which the United States and other creditor nations have helped deal with these problems. Full accounts of the two debt rescheduling arrangements (for India and Chile) in which the United States participated during fiscal year 1975 are also included.

FOREIGN INDEBTEDNESS TO THE UNITED STATES GOVERNMENT

The total principal outstanding on post-World War II foreign indebtedness to the United States Government amounted to $36.7 billion as of December 31, 1975. Of this, $35.6 billion was owed on long-term credits (maturities of over one year), $148 million on short-term credits (maturities of 90 days to one year), and $935 million was on accounts receivable (maturities of less than 90 days). Most of this foreign debt relates to United States foreign economic and military aid and export credit programs undertaken during the last thirty years. Some $15 billion of the indebtedness was contracted under the Foreign Assistance Act (and predecessor legislation) and the Foreign Military Sales Act. In addition, $5.7 billion was contracted under Public Law 480 programs, $10 billion under the Export-Import Bank Act and the Commodity Credit Corporation Charter Act, and $1.5 billion stems from activities related to World War II—primarily Lend-Lease and Surplus Property disposal.

Because the purpose of most of these loans was to promote economic development and assist the sale of exports of American goods and services, most—70 percent by value—of this debt is owed by the non-oil exporting developing countries.

With regard to long-term debt, the largest individual foreign debtors to the United States Government among the developing countries are: India ($3.6 billion), Pakistan ($2.4 billion), Brazil ($2.2 billion), Israel ($1.9 billion), Turkey ($1.5 billion), Korea ($1.4 billion), and Indonesia ($1.3 billion).

ARREARAGES ON FOREIGN INDEBTEDNESS TO THE UNITED STATES GOVERNMENT

Agencies of the United States Government emphasize the importance of prompt, on-time payment of foreign debt owed the United States. Congress requires regular reporting (under section 634 of the Foreign Assistance Act, for example) on the status of foreign debts owed to the United States and conducts periodic hearings on the subject, the latest of which was held by the Legislation and National Security Subcommittee of the House Committee on Government Operations on March 4, 1976.

The National Advisory Council exercises continuing oversight and coordination roles with respect to the identification and collection of delinquent debts owed to the United States Government. When the Council considers, and makes recommendations on, proposed loans by United States Government agencies and by international financial institutions such as the World Bank, at its weekly Staff Committee meetings, the status of arrearages and delinquencies on indebtedness to the United States is reviewed in detail. An NAC Working Group on foreign debt arrearages has also been established to coordinate activities under a new government-wide standard collection procedure and to advise the NAC Staff Committee on significant debt arrearages involving serious collection problems. These NAC activities accord with the terms of the Council's Action of September 15, 1971, which states *inter alia* that:

> "The National Advisory Council believes that the existence of significant debt arrearages to the U.S. Government or its agencies is an important consideration in passing judgment on specific loan proposals. As a general policy, the Council recommends that loans to countries whose governments are in arrears 90 days or more on debts which they or their agencies owe to the U.S. Government or its agencies should be deferred and, where appropriate, disapproved. Exceptions to this general rule must be explicitly approved."

The National Advisory Council holds special meetings periodically, attended by representatives of all major United States Government creditor agencies, to review foreign debt problems and to discuss ways and means of improving debt collection efforts. The most recent of these sessions was held in June 1976 and focused on a number of serious outstanding collection problems as well as on the implementation of the new standard collection procedure.

As has already been noted, it is United States Government policy that agencies should extend credits and loans to foreign countries and entities only on the explicit understanding that repayments will be made in accordance with the contractual terms and conditions agreed upon by the borrower at the time the loans and credits are authorized and signed. Since World War II, the vast majority of debts due to the United States have been paid on time. Of the total principal amount outstanding on long-term foreign indebtedness to the United States Government as of December 31, 1975 (excluding World War I debts); only about one percent was due and unpaid 90 days or more (Table 15).

TABLE 15.—*Arrearages on long-term U.S. Government Foreign credits extended during and since World War II, as of December 31, 1975*

[In millions of dollars and equivalents]

	War connected activities [1]	Export financing [2]	Foreign assistance activities: Foreign Assistance Acts [3]: Public Law 480 programs	Foreign assistance activities: Foreign Assistance Acts [3]: Country loans	Foreign assistance activities: Foreign Assistance Acts [3]: Financing military purchases	Foreign assistance activities: Other [3]	Total	Arrearages as percent of—: Credits utilized	Arrearages as percent of—: Principal outstanding
Credits utilized	5,341	27,465	11,042	15,850	3,345	5,527	68,570		
Repaid [4]	4,116	17,305	3,933	3,426	1,075	2,414	32,270		
Adjustments (net deduction) [5]	8	4	1,364	34		13	1,423		
Principal outstanding	1,520	10,291	5,721	12,390	2,270	3,397	35,589		
Arrearages:									
On principal	77	41	14	46	7	1	187	0.3	0.5
On interest	48	36	13	39	1	1	136	0.2	0.4
Subtotal [6]	125	77	27	85	7	2	323	0.5	0.9
Other [7]		47					47	0.1	0.1
Total	125	124	27	85	7	2	370	0.5	1.0

[1] Includes lend-lease and overseas surplus property sales.

[2] Includes Export-Import Bank and CCC general sales manager programs.

[3] Includes activity under Foreign Assistance Act and related programs. Activity for programs other than that explicitly shown is included in "Other"; see table B-2 in the Statistical Appendix.

[4] Includes repayments of $743 million on credits outstanding on July 1, 1975, and not included in "Credits utilized" above.

[5] Includes write-offs of principal, revaluations of indebtedness repayable in foreign currencies, and adjustments to outstanding principal for discount allowance for extraordinary prepayments.

[6] Table B-10 in the Statistical Appendix indicates principal and interest payments due and unpaid 90 days or more on long-term indebtedness on Dec. 31, 1975, totaling $323 million. This excludes $46.9 million of principal and interest due from the Republic of China for assets left on the Asian continent, for which Export-Import Bank by agreement with that Government has deferred from pressing.

[7] For the purposes of the present debt review, the Council has also included in the delinquent figures that portion of the Republic of China debt to Export-Import Bank ($46.9 million) referred to in footnote 6 above.

Source: U.S. Department of Commerce, Bureau of Economic Analysis, from information made available by operation agencies.

During the 24 month period from December 31, 1973, to December 31, 1975, the United States collected almost $6 billion, in U.S. dollars, on principal and interest due on long-term dollar credits, and the equivalent of almost $1 billion in principal and interest on foreign currency loans.[1] Arrearages on long-term debt to the United States also declined, by about $120 million, during this period. While part of this reduction in long-term arrearages reflects debt rescheduling agreements, the amount actually collected on foreign debts to the United States Government far exceeded new arrearages incurred. Foreign debt arrearages constitute but a very small portion of total debt falling due to, and being collected by, agencies of the United States Government. As of December 31, 1975 (latest date for which complete data are available) the total principal and interest delinquent on long-term and short-term credits and accounts receivable was $748 million. This compares with total delinquencies of $797 million as of December 31, 1973. The favorable trend in reducing debt arrearages can be expected to continue because of the active collection efforts of the United States Government.

There are, however, certain cases which are difficult to resolve through normal collection procedures. For example, more than half of total long-term, short-term and accounts receivable arrearages are complicated by extraordinary political situations. By far the largest arrearage in this group—$199 million—relates to military logistical support provided by the United States to other countries during the Korean conflict. While the United States has reached formal agreement for repayment of this assistance with fourteen countries, the accounts of six other countries have never been regularized. The history of these Korean conflict claims is complex and presents a unique situation. This is illustrated by the fact that the Thirty-Seventh Report (1976) of the Committee on Government Operations recommended that "Congress should consider legisla-

[1] This excludes indebtedness prepaid by the Government of India and simultaneously granted back by the United States according to mutually agreed terms specified in the original agreements of indebtedness.

tion removing the Korean War debt claim against Colombia, Ethiopia, Greece, the Philippines, Thailand, and Turkey from the Treasury Department's category of outstanding U.S. debts."

Chinese debt delinquencies total approximately $103 million [2] and involve a number of problems, including the proper allocation of claims between the Republic of China and the People's Republic of China, the correct evaluation of the amount of the claims, and problems of government succession. It has not been feasible to negotiate a settlement of Cuba's $70 million debt to United States Government agencies (mainly the Export-Import Bank) in the present state of United States relations with Cuba. Nevertheless, the United States intends to pursue this debt as well as outstanding United States Government and private claims against Cuba as soon as the state of bilateral relations permits. Collection of some $13 million of debts owed by Cambodia and Vietnam also may be politically difficult.

A second category of major long-term, short-term and accounts receivable arrearages includes those owed by Pakistan and Iran. These arrearages, combined, totalled $110 million as of December 31, 1975. Most of the Pakistan arrearage has now been regularized through the debt rescheduling agreement between the United States and Pakistan which became effective in April 1976 mentioned above.

During the past four years, the United States Government has been in regular communication with Iran in an effort to collect arrearages of $35 million owing on several Lend-Lease and Surplus Property agreements signed during the 1945–48 period. Efforts to collect these arrearages, on which payments were halted during the period of instability of the 1950's, are receiving priority attention and some payment has been received. In December 1974, Iran presented a note to the United States detailing claims totalling approximately $172 million, stemming from damages to Iranian railways by the Allied military forces during World War II, and requested that discussion of the Iranian Lend-Lease debts coincide with discussion of these claims against the United States.

The United States has discussed the Iranian claims but stresses that there is no legal or factual connection between the Iranian claims and the Lend-Lease and Surplus Property debts to the United States. Iran has not disputed the validity of its obligations to the United States, and made payments of $750,000 in March 1973, and $1.8 million in October 1975. Iranian representatives have stated, however, that further payments would be contingent on negotiation of Iranian claims against the United States. The United States welcomed the latest payments on the Lend-Lease debt, but continues to emphasize the importance of full and prompt repayment of the debt.

The remaining category of other long-term, short-term, and accounts receivable arrearages totalled about $205 million as of December 31, 1975. Many of these arrearages reflect technical and administrative problems or bankruptcies in the private sector.

UNITED STATES GOVERNMENT CLAIMS AGAINST FOREIGN GOVERNMENTS

The Treasury Department recently compiled, in cooperation with other NAC agencies, a preliminary report to Congress on outstanding United States Government claims against foreign governments. This information was provided in response to a request made by the Legislation and National Security Subcommittee of the House Committee on Government Operations during its hearings on March 4, 1976. A claim against a foreign government is defined as an amount the United States Government asserts, or may in the future wish to assert, is owed to the United States, but which the foreign government disputes. Only when the foreign government and the United States Government agree on a specific amount and terms of payment does the claim become a debt. Because of the nature of claims and the negotiation process, the Treasury report does not specify precise values for these claims, the largest of which are against China and Cuba. Pursuit of these claims is, however, complicated by the same special political problems which impede debt arrearage settlements with these countries.

WORLD WAR I DEBTS

During and immediately after World War I the Allied Powers borrowed about $10.4 billion from the United States. After deducting repayments of $2.8 billion and taking into account unpaid interest charges which now exceed the amount of the original borrowing, the outstanding foreign indebtedness to the United States on World War

[2] Excludes $46.9 million of principal and interest due from the Republic of China for assets left on the Asian continent for which Export-Import Bank, by agreement with that Government, has deferred from pressing.

I account totalled approximately $24.4 billion as of June 30, 1976, of which $20.6 billion was delinquent. The larger of these due and unpaid accounts are with the United Kingdom ($9.7 billion), France ($6.7 billion) and Italy ($1.7 billion). In addition to these Allied debts, there is outstanding German indebtedness of 4.5 billion Reichsmarks (approximately $1.8 billion at the rate of exchange at the time of default).

These World War I debts present special problems. After the War the United States Government collected about $1 billion on the initial Allied borrowings. Collection was, however, complicated by the general financial disorders which prevailed in the postwar period and the United States concluded debt funding agreements with most of these countries during the period 1923 to 1930. Most debtor countries fulfilled their commitments under these debt funding agreements until 1933–34. Aside from a few countries, however, the debtor governments have made no payments since that time. Total collections under these funding agreements amounted to about $1.8 billion as of June 30, 1975. The principal debtor governments (except the Soviet Union which repudiated, in January 1918, all foreign debt incurred during the former Czarist regime) have never denied the legal validity of the debts. Still, the debts are, as a practical matter, inextricably linked to the question of German war reparations and the intra-European debts generated during World War I. Many European countries are net creditors on account of World War I indebtedness, with Germany owing more to them than they in turn owe to the United States. Since the early 1930's these countries have steadfastly maintained that they would resume payments on their war debts to the United States only if the issue of Germany's World War I reparations was satisfactorily settled.

Under the 1953 London Agreement on German external debts, to which the United States is a party, resolution of the problem of intergovernment claims against Germany arising from World War I was deferred "until a final general settlement of this matter." This agreement was ratified by the United States Senate and has the status of a treaty. In the 1953 agreement, the Federal Republic of Germany agreed to pay the United States Government $97.5 million to settle claims of American nationals and, under a 1969 agreement the Federal Republic of Germany provided the funds needed to liquidate this indebtedness by 1978.

While the United States has never recognized any legal connection between World War I debt obligations owed to this country and reparation claims on Germany, there is a linkage in reality. A working group of the National Advisory Council is charged with reviewing this complex problem.

DEBT REPORTING AND COLLECTION PROCEDURES

Under section 634 (f) of the Foreign Assistance Act, as amended, the Treasury Department is responsible for the compilation of data on foreign indebtedness owed to the United States Government and arrearages on such debts. Treasury regularly receives from all United States Government agencies semiannual statements of long-term and short-term debts and accounts receivable owed to the United States by foreigners. This reporting system is currently being improved to provide quarterly coverage. Information is also being compiled on debts in each category which are due and unpaid 90 days or more. These data are used as a basis for taking appropriate steps to insure prompt collection of debt as well as in assisting the Congress in its work.

During fiscal year 1976 several steps were taken to improve the debt collection procedures of United States Government agencies. The Export-Import Bank has recently established a computerized program for automatically billing debtors 45 days prior to due date of payment. When fully implemented, this system will help to limit the level of delinquent accounts for Export-Import Bank transactions. The Department of Defense has developed standardized procedures for Foreign Military Sales program transactions of all the Armed Services, including uniform billing, cash collection, and delivery reporting.

Finally, the National Advisory Council recently established a standard United States Government procedure for collecting foreign debt arrearages. Primary responsibility for collection lies with the creditor agency but in cases where the vigorous efforts of a creditor agency have been unsuccessful in collecting significant arrearages, the Department of State provides assistance and the National Advisory Council is notified. If Department of State efforts are also unsuccessful, the National Advisory Council reviews such long-standing arrearage cases and recommends further steps for the collection effort, including the use of its formal procedure for the deferral or disapproval of proposed loans to countries whose governments are in arrears ninety days or more on debts which they or their agencies owe to the United States Government or its agencies.

APPENDIX A

ORGANIZATION, FUNCTIONS AND OPERATIONS OF THE NATIONAL ADVISORY COUNCIL ON INTERNATIONAL MONETARY AND FINANCIAL POLICIES

Organization and Functions

The National Advisory Council on International Monetary and Financial Policies (NAC) is responsible for coordinating U.S. participation in the international financial institutions as well as the policies and practices of all agencies of the U.S. Government which make, or participate in making, foreign loans or which engage in foreign financial, exchange, or monetary transactions.

The NAC was originally established by the Bretton Woods Agreements Act of July 31, 1945. It was abolished, as a statutory entity, under the terms of the Executive Reorganization Plan No. IV of 1965, which transferred its functions to the President of the United States. With a few changes in functions, however, Executive Orders No. 11238 (July 28, 1965) and No. 11269 (February 14, 1966) reestablished the NAC with the same membership it previously had. This Reorganization Plan also authorized the Secretary of the Treasury to "instruct representatives of the United States to the international financial organizations," a function with which the NAC, as a statutory entity, had previously been charged. The texts of Executive Orders No. 11238 and No. 11269, and the sections of the Bretton Woods Agreements Act Relating to the National Advisory Council are printed below.

The NAC is basically an advisory body but it is authorized to review proposed individual loans or other transactions to the extent necessary or desirable to coordinate policies. The NAC seeks to assure that, to the maximum extent feasible, operations of the international financial institutions (e.g., the World Bank, the Inter-American Development Bank and the Asian Development Bank) are conducted in a manner consonant with U.S. policies and objectives and the lending and other foreign financial activities of U.S. Government agencies. The NAC formulates and reviews policies and programs for use by the U.S. representatives to these institutions and provides advice to the Secretary of the Treasury, as U.S. Governor of the international financial institutions, on the policies and proposed transactions of these institutions. The NAC also advises the Secretary of the Treasury on proposed actions by these institutions requiring United States approval in such areas as the flotation of securities, increases in quotas and subscriptions, and changes in their Articles of Agreement. The NAC may also advise on certain important problems arising in the administration, and management of the international financial institutions and is a mechanism for providing the oversight required to assure that these institutions are efficiently fulfilling their functions and making effective use of funds available to them.

The members of the NAC, at the Principal's level, as of June 30, 1976, were as follows:

The Secretary of the Treasury, William E. Simon, *Chairman*.

The Assistant to the President for Economic Affairs, L. William Seidman, *Deputy Chairman*.

The Secretary of State, Henry A. Kissinger.

The Secretary of Commerce, Elliot L. Richardson.

The Chairman of the Board of Governors of the Federal Reserve System, Arthur F. Burns.

The President and Chairman of the Board of Directors of the Export-Import Bank of the United States, Stephen McKenzie DuBrul, Jr.

The NAC is served by a Committee of Alternates, at the Assistant Secretary level, empowered to act for their Principals. By agreement, the following served as NAC Alternates as of June 30, 1976:

Gerald L. Parsky, Assistant Secretary of the Treasury for International Affairs.

Joseph A. Greenwald, Assistant Secretary of State for Economic and Business Affairs.

Richard G. Darman, Assistant Secretary of Commerce for Policy.

Henry C. Wallich, Member, Board of Governors of the Federal Reserve System.

Walter C. Sauer, First Vice-President and Vice Chairman, Export-Import Bank of the United States.

Informal meetings of the NAC for preliminary policy-level discussions of upcoming international issues and problems are held roughly once a month, chaired by the Deputy Assistant Secretary of the Treasury for Developing Nations Finance. These sessions are designed to provide informal guidance to NAC agencies on policy matters, to establish work programs for the NAC Alternates and direct the activity of the NAC Staff Committee and of the various NAC Working Groups. Unstructured, these meetings provide an opportunity for intermediate level policy discussion within the formal NAC framework.

The NAC is also served by a Staff Committee, comprising economists, lawyers, and other professional members of NAC agencies which meets at least once a week to review international monetary and financial transactions within the NAC's area of responsibility. The bulk of the day-to-day work of the NAC is conducted in this Staff Committee. Representatives of other agencies of the U.S. Government such as the Departments of Defense and Agriculture, and representatives of AID, CIEP, NSC, and the OMB participate in the work of the NAC on a regular basis as appropriate. The NAC also utilizes ad hoc working groups to consider particular issues and report recommendations to the NAC Staff Committee. During fiscal 1976 topics considered by NAC Working Groups included: export financing and foreign debt problems.

U.S. representatives on the international financial institutions and their staffs participate in the work of the NAC on a regular basis. They were, at the end of the period under review:

U.S. Executive Director of the International Monetary Fund, Sam Y. Cross (Thomas B. C. Leddy, Alternate).

U.S. Executive Director of the International Bank for Reconstruction and Development and of the International Development Association and U.S. Director of the International Finance Corporation, Charles A. Cooper (Hal Reynolds, Alternate).

U.S. Executive Director of the Inter-American Development Bank, John M. Porges (Yan M. Ross, Alternate).

U.S. Director of the Asian Development Bank, L. Roy Papp (Henry Lee, Alternate).

(The Office of the U.S. Director of the Asian Development Bank—USADB—is located at the Bank's headquarters in Manila, the Philippines. NAC consultation and coordination with both USADB and U.S. Embassies in loan recipient countries are carried out by cable and letter.)

Robert S. Watson (Treasury) is the Secretary of the NAC and Chairman of the NAC Staff Committee. William C. Grant (Treasury) is deputy to the Secretary of the NAC and also serves as Secretary of the weekly meetings of the NAC Staff Committee.

Operations

During its 30 years of existence, the NAC has constituted a unique mechanism for bringing high-level interdepartmental focus in a timely fashion on the international financial and monetary problems confronting the United States. The NAC seeks to maximize effectiveness in the exchange of information and views among participating agencies necessary for the full consideration of policy options. Formal meetings of the Staff Committee are held at least weekly throughout the year. (There were 63 Staff Committee meetings during fiscal 1976.) The NAC Principals and their Alternates meet, formally and less frequently, on call. (There were eight formal meetings of the NAC Alternates during fiscal 1976.) And, in addition to the monthly meetings of the informal NAC group, informal contact at all levels amongst NAC agencies is maintained on a regular basis throughout the year.

Through the Office of the Secretary of the NAC, which is staffed by the Treasury Department, documents and memoranda pertaining to the work of the NAC are received from and circulated to the various participating agencies. Each agency assigns professional staff personnel to the work of scrutinizing the documentation associated with each proposal in the light of the agency's responsibilities and interests.

Following in-depth analysis and discussion of each pending proposal, such as an individual loan proposal, the NAC normally takes a vote in reaching its position, which is recorded in a document denominated as an NAC "Action." During fiscal year 1976 the NAC took 816 formal Actions on individual proposals as well as general policy questions (as compared with 740 Actions during fiscal 1975 and 639 Actions in fiscal 1974). In addition, many subjects were discussed and studied which did not require formal NAC Actions. The Council seeks, where possible, unanimity of views. Nevertheless, split voting occurs. In such cases, this may signal that a particular aspect of U.S. policy needs special review. In all cases, however, NAC Actions are taken on behalf of the NAC Principals to ensure that appropriate policy-level attention is focussed on the particular policy issue or transaction involved.

The NAC reports annually to the President and to the Congress on its activities. It also prepares special reports on such topics as proposed replenishments of the resources of the multilateral development banks, debt reschedulings, and other significant topics involving international monetary and financial affairs. A recent example of such reports is the NAC *Special Report to the President and to the Congress on Amendment of the Articles of Agreement of the International Monetary Fund and on an Increase in Quotas in the International Monetary Fund* (House Document 94–447, April 8, 1976).

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Executive Order No. 11238

July 28, 1965.

THE NATIONAL ADVISORY COUNCIL ON INTERNATIONAL MONETARY AND FINANCIAL PROBLEMS

By virtue of the authority vested in me by Reorganization Plan No. 4 of 1965, and as President of the United States, it is ordered as follows:

SECTION 1. There is hereby established a new "National Advisory Council on International Monetary and Financial Problems." That Council shall have the same membership, functions, and status as the Council of the same name established by Section 4 of the Bretton Woods Agreements Act (59 Stat. 512; 22 U.S.C. 286b) had immediately prior to the taking effect of Reorganization Plan No. 4 of 1965.

SEC. 2. This Order shall be effective as of July 27, 1965, and, together with the Council established by Section 1, shall terminate on January 1, 1966, or on such earlier date as may hereafter be prescribed.[1]

LYNDON B. JOHNSON.

THE WHITE HOUSE,

[1] See E.O. 11269, following.

Executive Order No. 11269

February 14, 1966.

NATIONAL ADVISORY COUNCIL ON INTERNATIONAL MONETARY AND FINANCIAL POLICIES

By virtue of the authority vested in me by Reorganization Plan No. 4 of 1965 (30 F.R. 9353), and as President of the United States, it is ordered as follows:

SECTION 1. *Establishment of Council.* (a) There is hereby established the National Advisory Council on International Monetary and Financial Policies, hereinafter referred to as the Council.

(b) The Council shall be composed of the following members: the Secretary of the Treasury, who shall be the Chairman of the Council. The Assistant to the President for Economic Affairs, who shall be Deputy Chairman of the Council,[1a] the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the President of the Export-Import Bank of Washington.

(c) Whenever matters within the jurisdiction of the Council may be of interest to Federal agencies not represented on the Council under Section 1 (b) of this order, the Chairman of the Council may consult with such agencies and may invite them to designate representatives to participate in meetings and deliberations of the Council.

SEC. 2. *Functions of the Council.* (a) Exclusive of the functions delegated by the provisions of Section 3, below, and subject to the limitations contained in subsection (b) of this Section, all of the functions which are now vested in the President in consequence of their transfer to him effected by the provisions of Section 1 (b) of Reorganization Plan No. 4 of 1965 are hereby delegated to the Council.

(b) The functions under Sections 4 (a) and 4(b) (3) of the Bretton Woods Agreement Act, including those made applicable to the International Finance Corporation, the Inter-American Development Bank, and the International Development Association (22 U.S.C. 286b (a) and (b) (3); 283b; 284b), to the extent that such functions consist of coordination of policies, are hereby delegated to the Council. The functions so delegated shall be deemed to include the authority to review proposed individual loan, financial, exchange, or monetary transactions to the extent necessary or desirable to effectuate the coordination of policies.

[1a] Added by E.O. 11808, September 30, 1974.

(c)[2] The Council shall perform with respect to the Asian Development Bank, the same functions as those delegated to it by subsections (a) and (b) of this section with respect to other international financial institutions.

SEC. 3. *Functions of the Secretary of the Treasury.* (a) Functions which are now vested in the President in consequence of their transfer to him effected by the provisions of Section 1 (b) of Reorganization Plan No. 4 of 1965 are hereby delegated to the Secretary of the Treasury to the extent of the following:

(1) Authority to instruct representatives of the United States to international financial organizations.

(2) Authority provided for in Section 4 (b) (4) of the Bretton Woods Agreements Act (22 U.S.C. 286b (b) (4)).

(b) In carrying out the functions delegated to him by subsection (a) of this Section the Secretary shall consult with the Council.

(c) Nothing in this order shall be deemed to derogate from the responsibilities of the Secretary of State with respect to the foreign policy of the United States.

(d) The Secretary of the Treasury shall perform, with respect to the Asian Development Bank, the same functions as those delegated to him by subsections (a) and (b) of this section with respect to other international financial institutions.

SEC. 4. *Information.* (a) All agencies and officers of the Government, including representatives of the United States to international financial organizations, (1) shall keep the Council or the Secretary of the Treasury, as the case may be, fully informed concerning the foreign loan, financial, exchange, and monetary transactions in which they engage or may engage or with respect to which they have other responsibility, and (2) shall provide the Council and the Secretary with such further information or data in their possession as the Council or the Secretary, as the case may be, may deem necessary to the appropriate discharge of the responsibilities of the Council and Secretary under Sections 2 and 3 of this order, respectively.

(b) The Council shall from time to time transmit to all appropriate agencies and officers of the Government statements of the policies of the Council under this order and such other information relating to the above-mentioned transactions or to the functions of the Council hereunder as the Council shall deem desirable.

[2] Sec. 2 (c) and Sec. 3 (d) were added by E.O. 11334, March 7, 1967.

SEC. 5. *Executive Order No. 10033.* Section 2 (a) of Executive Order No. 10033 of February 8, 1949, is hereby amended by substituting for the name "National Advisory Council on International Monetary and Financial Problems" the following: "National Advisory Council on International Monetary and Financial Policies."

SEC. 6. *Effective date.* The provisions of this order shall be effective as of January 1, 1966.

LYNDON B. JOHNSON.

THE WHITE HOUSE,

SECTIONS OF THE BRETTON WOODS AGREEMENTS ACT AS AMENDED RELATING TO THE NATIONAL ADVISORY COUNCIL

(59 Stat. 512; 22 U.S.C. 286b, 286k, 286k–1)

NATIONAL ADVISORY COUNCIL ON INTERNATIONAL MONETARY AND FINANCIAL PROBLEMS

SEC. 4. (a) In order to coordinate the policies and operations of the representatives of the United States on the Fund and the Bank and of all agencies of the Government which make or participate in making foreign loans or which engage in foreign financial, exchange or monetary transactions, there is established the National Advisory Council on International Monetary and Financial Problems (hereinafter referred to as the "Council"), consisting of the Secretary of the Treasury, as Chairman, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve System, the President of the Export-Import Bank of Washington, and during such period as the Foreign Operations Administration shall continue to exist, the Director of the Foreign Operations Administration. (As amended by 62 Stat. 137, 141; 65 Stat. 373, 378; 68 Stat. 678.)[1]

(b) (1) The Council, after consultation with the representatives of the United States on the Fund and the Bank, shall recommend to the President general policy directives for the guidance of the representatives of the United States on the Fund and the Bank.

(2) The Council shall advise and consult with the President and the representatives of the United States on the Fund and the Bank on major problems arising in the administration of the Fund and the Bank.

(3) The Council shall coordinate, by consultation or otherwise, so far as is practicable, the policies and operations of the representatives of the United States on the Fund and the Bank, the Export-Import Bank of Washington and all other agencies of the Government to the extent

[1] See section 4 of the IFC Act, section 4 of the IDB Act, section 4 of the IDA Act, all cited below.

that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions.

(4) Whenever, under the Articles of Agreement of the Fund or the Articles of Agreement of the Bank, the approval, consent, or agreement of the United States is required before an act may be done by the respective institutions, the decision as to whether such approval, consent, or agreement, shall be given or refused shall (to the extent such decision is not prohibited by section 5 of this Act) be made by the Council, under the general direction of the President. No governor, executive director, or alternate representing the United States shall vote in favor of any waiver of condition under Article V, section 4, or in favor of any declaration of the United States dollar as a scarce currency under Article VII, section 3, of the Articles of Agreement of the Fund, without prior approval of the Council.

(5) The Council shall transmit to the President and to the Congress an annual report with respect to the participation of the United States in the Fund and Bank.

(6) Each such report shall contain such data concerning the operations and policies of the Fund and Bank, such recommendations concerning the Fund and the Bank, and such other data and material as the Council may deem appropriate.

(7) The Council shall make such reports and recommendations to the President as he may from time to time request, or as the Council may consider necessary to more effectively or efficiently accomplish the purposes of this Act or the purposes for which the Council is created.

(c) The representatives of the United States on the Fund and the Bank, and the Export-Import Bank of Washington (and all other agencies of the Government to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions) shall keep the Council fully informed of their activities and shall provide the Council with such further information or data in their possession as the Council may deem necessary to the appropriate discharge of its responsibilities under this Act.

* * *

FURTHER PROMOTION OF INTERNATIONAL ECONOMIC RELATIONS

SEC. 14. In the realization that additional measures of international economic cooperation are necessary to facilitate the expansion and balanced growth of international trade and render most effective the operations of the Fund and the Bank, it is hereby declared to be the policy of the United States to seek to bring about further agreement and cooperation among nations and international bodies as soon as possible, on ways and means which will best reduce obstacles to and restrictions upon international trade, eliminate unfair trade practices, promote mutually advantageous commercial relations, and otherwise facilitate the expansion and balanced growth of international trade and promote the stability of international economic relations. In considering the policies of the United States in foreign lending and the policies of the Fund and the Bank, particularly in conducting exchange transactions, the Council and the United States representatives on the Fund and the Bank shall give careful consideration to the progress which has been made in achieving such agreement and cooperation.

SEC. 15. [For text, see below.]

AMENDMENTS TO THE NATIONAL BANK ACT AND THE BRETTON WOODS AGREEMENTS ACT

(63 Stat. 298; 73 Stat. 299)

Paragraph Seven of section 8 of the National Bank Act, as amended (U.S.C., title 12, sec. 24) was amended by adding to the end thereof the following sentence: "The limitations and restrictions herein contained as to dealing in and underwriting investment securities shall not apply to obligations issued by the International Bank for Reconstruction and Development or the Inter-American Development Bank which are at the time eligible for purchase by a national bank for its own account: *Provided,* that no association shall hold obligations issued by either of said banks as a result of underwriting, dealing, or purchasing for its own account (and for this purpose obligations as to which it is under commitment shall be deemed to be held by it) in a total amount exceeding at any one time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund."

The Bretton Woods Agreements Act, as amended (U.S.C., title 22, secs. 286–286k), was amended by adding at the end thereof a new section to be numbered section 15 and to read as follows:

"SEC. 15. (a) Any securities issued by International Bank for Reconstruction and Development (including any guaranty by the bank, whether or not limited in scope), and any securities guaranteed by the bank as to both principal and interest, shall be deemed to be exempted securities within the meaning of paragraph (a) (2) of section 3 of the Act of May 27, 1933, as amended (U.S.C., title 15, sec. 77c), and paragraph (a) (12) of section 3 of the Act of June 6, 1934, as amended (U.S.C., title 15, sec. 78c). The bank shall file with the Securities and Exchange Commission such annual and other reports with regard to such securities as the Commission shall determine to be appropriate in view of the special character of the bank and its operations and necessary in the public interest or for the protection of investors.[2]

"(b) The reports of the National Advisory Council provided for in section 4 (a) (6) [3] of the Bretton Woods Agreements Act shall also cover and include the effectiveness of the provisions of section 15 (a) of this Act and the exemption for securities issued by the bank provided by section 8 of the National Bank Act in facilitatng the operations of the bank and the extent to which the operations of the bank may assist in financing European recovery and the reconstruction and development of the economic resources of member countries of the bank and the recommendations of the Council as to any modifications it may deem desirable in the provisions of this Act." [4]

Reporting Requirement of Chapter 3 of Public Law 91–599 (84 Stat. 1658), Approved December 30, 1970

Sec. 31. Annual Report

"The National Advisory Council on International Monetary and Financial Policies shall include in its annual report to the Congress (1) a statement with respect to each loan approved and outstanding, made by the International Bank for Reconstruction and Development, the International Development Association, the Inter-American Development Bank, and the Asian Development Bank, including an evaluation of new loans made by said organization and a progress report of the project covered by each loan, and a discussion of how each loan will benefit the people of the recipient country, and (2) a statement on steps taken jointly and individually by member countries of the Inter-American Development Bank to restrain their military expenditures, and to preserve and strengthen free and democratic institutions."

Suspension of Right of International Bank to Issue Securities Under Section 286k–1: Report of Securities and Exchange Commission [22 U.S.C. 286k–2.]

Sec. 3. The Securities and Exchange Commission acting in consultation with the National Advisory Council on International Monetary and Financial Problems is authorized to suspend the provisions of section 15 (a) of the Bretton Woods Agreements Act at any time as to any or all securities issued or guaranteed by the bank during the period of such suspension. The Commission shall include in its annual reports to Congress such information as it shall deem advisable with regard to the operations and effect of this Act and in connection therewith shall include any views submitted for such purpose by any assocation of dealers registered with the Commission.[5]

Section of the International Finance Corporation Act Relating to the National Advisory Council

(69 Stat. 669; 22 U.S.C. 282b)

Sec. 4. The provisions of section 4 of the Bretton Woods Agreements Act, as amended (22 U.S.C. 286b), shall apply with respect to the Corporation to the same extent as with respect to the International Bank for Reconstruction and Development. Reports with respect to the Corporation under paragraphs 5 and 6 of subsection (b) of section 4 of said Act, as amended, shall be included in the first report made thereunder after the establishment of the Corporation and in each succeeding report.

Section of the Inter-American Development Bank Act Relating to the National Advisory Council

(73 Stat. 299; 22 U.S.C. 283b)

Sec. 4. The provisions of section 4 of the Bretton Woods Agreements Act, as amended (22 U.S.C. 286b), shall apply with respect to the Bank to the same extent as with respect to the International Bank for Reconstruction and Development and the International Monetary Fund. Reports with respect to the Bank under paragraphs (5) and (6) of subsection (b) of

[2] Substantially equivalent provisions regarding the securities issued by the Inter-American Development Bank in connection with the raising of funds for its ordinary capital resources were enacted in Public Law 86–147, section 11 (a): 22 USCA 283h (a).

[3] So in original. Probably should read "section 4(b) (6)".

[4] Equivalent provisions with regard to the operations of the Inter-American Development Bank were enacted in Public Law 86–147, section 12; 22 USCA 283.

[5] Equivalent provisions regarding securities issued by the Inter-American Development Bank were enacted in Public Law 86–147, section 11 (b); 22 USCA 283h (b).

section 4 of said Act, as amended, shall be included in the first report made thereunder after the establishment of the Bank and in each succeeding report.

Section of the International Development Association Act Relating to the National Advisory Council
(74 Stat. 293; 22 U.S.C. 284)

Sec. 4. The provisions of section 4 of the Bretton Woods Agreements Act, as amended (22 U.S.C. 286b), shall apply with respect to the Association to the same extent as with respect to the International Bank for Reconstruction and Development and the International Monetary Fund. Reports with respect to the Association under paragraphs (5) and (6) of subsection (b) of section 4 of said Act as amended, shall be included in the first report made thereunder after the establishment of the Association and in each succeeding report.

Ex. Ord. No. 10033. Regulations Governing the Providing of Statistical Information to Intergovernmental Organizations

Ex. Ord. No. 10033, Feb. 8, 1949, 14 F.R. 561, as amended by Ex. Ord. No. 11269, Feb. 14, 1966, 31 F.R. 2813, provides:

Sec. 1. Except as provided in section 2 hereof, the Director of the Bureau of the Budget, hereinafter referred to as the Director, (a) shall determine, with the concurrence of the Secretary of State, what statistical information shall be provided in response to official requests received by the United States Government from any intergovernmental organization of which this country is a member, and (b) shall determine which Federal executive agency or agencies shall prepare the statistical information thus to be provided. The statistical information so prepared shall be transmitted to the requesting intergovernmental organization through established channels by the Secretary of State or by any Federal executive agency now or hereinafter authorized by the Secretary of State to transmit such information.

Sec. 2. (a) The National Advisory Council on International Monetary and Financial Policies, hereinafter referred to as the National Advisory Council, shall determine, after consultation with the Director, what information is essential in order that the United States Government may comply with official requests for information received from the International Monetary Fund or the International Bank for Reconstruction and Development.

(b) The Director shall determine which Federal executive agency or agencies shall collect or make available information found essential under section 2 (a) hereof.

(c) In the collection of information pursuant to a determination made by the Director under section 2 (b) hereof in response to a request under article VIII, section 5, of the Articles of Agreement of the International Monetary Fund, the authority conferred on the President by section 8 of the Bretton Woods Agreements Act to require any person to furnish such information, by subpoena or otherwise, may be exercised by each of the following-named agencies:

Department of Agriculture.
Department of Commerce.
Department of the Interior.
Department of Labor.
Department of the Treasury.
Board of Governors of the Federal Reserve System.
Federal Communications Commission.
Federal Deposit Insurance Corporation.
Federal Power Commission.
Federal Trade Commission.
Interstate Commerce Commission.
Securities and Exchange Commission.
United States Maritime Commission.
United States Tariff Commission.

(d) The information collected or made available under section 2 of this order shall be submitted to the National Advisory Council for review and for presentation to the said Fund or Bank.

(e) As used in this order, the word "person" means an individual, partnership, corporation, or association.

Sec. 3. The Director's determination of any matter under section 1 or section 2 (b) of this order shall be made after consulting appropriate Federal executive agencies and giving due consideration to any responsibility now exercised by any of them in relation to an intergovernmental organization.

Sec. 4. This order shall not be construed to authorize the Director or the National Advisory Council to provide, or to require any Federal executive agency to provide, to an intergovernmental organization (a) information during any period of time when the agency having primary responsibility for security of the specified information declares that it must be withheld from the intergovernmental organization in the interest of military security, or (b) information which any Federal executive agency is required by law to maintain on a confidential basis.

SEC. 5. The Director and the National Advisory Council are authorized to prescribe such regulations as may be necessary to carry out their respective responsibilities under this order.

SEC. 6. To the extent that this order conflicts with any previous Executive order, the provisions of this order shall control.

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APPENDIX B

LATIN AMERICAN DEFENSE EXPENDITURES

Introduction

This portion of the National Advisory Council's Annual Report deals with Latin American defense expenditures, a subject which continues to be of concern to the U.S. Congress. This section of the Report assesses the impact of defense-related spending on the region as a whole and on the capacities of selected countries to support and absorb such expenditures.

The Appendix reviews historical trends in Latin American military spending, identifies the periods of major emphasis on military related expenditures, examines the role of the United States and other supplier nations, discusses some of the factors that tend to obscure the impact of such spending and concludes with a discussion of major trends and prospects for the future.

Historical Background

A proper understanding of the relative magnitude and significance of Latin American military spending needs to be viewed against the background of recent history. Only in this perspective can the modest nature of regional arms spending be comprehended and deviations from historic norms correctly interpreted.

For a variety of reasons, Latin American nations have traditionally purchased armaments from a wide spectrum of suppliers, primarily European. The United States, prior to World War II, played only a minor role as a supplier of military equipment to Latin countries. In early 1941, however, Latin America was included in the Lend-Lease Program when President Roosevelt certified that the defense of Latin America was vital to the defense of the United States. Agreements were negotiated subsequently with eighteen Latin American nations under this program.

With the entrance of the United States into the war and the consequent enforced isolation of the Hemisphere, this country became virtually the sole source of supply of armaments to Latin America. By 1945, some 324 million dollars worth of equipment had been provided to the Latin region, primarily to Brazil, which was outfitting an expeditionary force for combat in Italy in 1944. The war years thus helped establish the United States as the largest supplier of military equipment to the region through a series of sale, grant and loan programs, a role which it played unchallenged for nearly two decades. It is worthy of note, and germane to this Report, that the United States had, as early as 1945, already expressed concern over the economic impact continued military assistance might have on Latin America. Furthermore, restrictions were placed on the provision of military assistance if there was reason to believe that recipient nations would use their newly acquired weaponry to wage war upon each other, or if the arms were to be used to suppress internal dissent. All three factors have continued to be fundamental to United States military assistance policies and programs in Latin America during the last three decades.

European suppliers were not idle during the post-war years and their large surpluses of combat equipment, primarily ships and aircraft, found ready customers among the Latin American nations. With the Cold War in Europe, U.S. official attention had swung away from the Hemisphere, and the Mutual Defense Assistance Act of 1949 did not include Latin America among its beneficiaries. By that time, however, Great Britain had sold a first one hundred Meteor jet fighters to Argentina and orders were subsequently placed in Europe for thirteen major naval combatant vessels. With the passage of the Mutual Security Act in 1951, the United States began to enter into military assistance agreements with the nations of Latin America. The agreement with Ecuador was the first to be signed (1952) and by 1955 eleven nations had mutual security agreements with the United States.

By the mid-to-late 1960's, however, the six major South American countries once again turned to their traditional European suppliers of armaments. During the 1967-72 period, Argentina, Brazil, Chile, Colombia, Peru, and Venezuela accounted for 97 percent of all military equipment orders placed by Latin American countries and 75 percent of those orders were placed in Western Europe, primarily the United Kingdom, France, and Western Germany. In contrast, the United States received only 13 percent of Latin military equipment orders during the same period while Canada accounted for 10 percent of the market and Australia for 2 percent. For the Latin American region as a whole, the United States provided about 30 percent and European suppliers about 70 percent of all military equipment and supplies purchased during this period.

Several major factors accounted for this shift in Latin American arms purchasing, not the least of which was European willingness to introduce into the area new and advanced weapons systems such as the supersonic Mirage fighter aircraft and a wide variety of tactical missile systems. Extremely favorable, if not concessionary, financing terms offered by European suppliers, contrasted with restrictive legislation and political and economic constraints on United States abilty to respond to Latin American arms requests, accelerated the trend towards European suppliers. Another important factor was the growing trend for Latin America to assert greater independence from the United States, manifested in a desire to diversify sources of arms supply.

Generally speaking, European sales of military equipment in Latin America reached a peak in 1970 reflecting not only increased availability of equipment but also concerted Latin efforts to modernize and replace aging equipment, particularly combat aircraft and naval vessels. Sharply higher unit costs of new production items, increased sophistication and inflation drove Latin American military spending to a level five times higher than the previous recorded peak during the 1950's.

Recent Trends

Although Latin American spending for military equipment and related goods and services peaked in the late 1960's and early 1970's, the region as a whole spent slightly more for this purpose in 1973 and 1974 than during the previous four years. By 1975, arms sales to Latin America by some 27 supplier nations reached a record high, something in excess of one billion dollars. For the 1970-75 period, more than half the major purchases were for navies, principally Argentina and Venezuela with most of the balance devoted to aircraft and tank procurement.

Six countries—Argentina, Brazil, Chile, Ecuador, Peru, and Venezuela—accounted for more than 85 percent of the nearly four billion dollars worth of armaments purchased by Latin America during the 1970-75 time frame. Of this total almost three-fourths came from the principal West European suppliers.

The European supplier share of the Latin American military equipment market dropped sharply during 1973-74, about 40 percent of the regional total while the United States increased its share of the market from less than 10 percent to more than 40 percent in the same period. This substantial increase in U.S. sales stemmed primarily from major purchases or commitments by Brazil and Chile for the F-5E fighter and the A-37B light attack aircraft. At the same time, however, some other countries, including Argentina, Colombia, and Venezuela, reduced expenditures for military materiel in part because of the drastic changes in the world petroleum market. A dual effect occurred in Latin American arms spending directly attributable to the world price of oil: some oil consuming nations were forced to alter or curtail defense spending while other countries, such as Ecuador, were able to exploit their new found affluence in the world arms market.

Despite the large relative increase in Latin American military spending since 1967, little in the way of major new equipment or weapons systems has appeared in the area, notable exceptions being the Mirage fighter ordered first by Peru and subsequently by Argentina, Brazil, Colombia, and Venezuela; French AMX-13 and AMX-30 tanks; and Soviet T-54/55 tanks in Peru together with other equipment including missile systems and some new naval combatant vessels, including 1,000 ton coastal submarines ordered from West Germany. Most recent major acquisitions continue, however, to be concentrated on equipment for air and naval forces which, for the most part, are still characterized by Korean war vintage aircraft and World War II era ship inventories. Latin American ground forces have felt the impact of new equipment deliveries the least, although there is a trend toward replacing aging tanks, some predating World War II, with new light and medium tanks and armored personnel carriers.

A factor that continues to influence Latin American military spending is the pattern of widespread purchasing from a diversity of suppliers. This practice has created pressures to replace the multiplicity of weapons systems as logistical capabilities prove inadequate to support such a variety of obsolescent equipment. Despite these pressures and the lessons of history, Latin nations are again demonstrating reluctance to depend upon any country as sole supplier of military equipment and related assistance. Consequently, new acquisitions should continue to reflect the historical pattern of diversity with concomitant maintenance, training and standardization problems.

Needs for force modernization and replacement of aging and unsupportable equipment continue to be the dominant motivations behind Latin American military spending. Despite substantial infusions of new equipment, the majority of Latin American military materiel dates from World War II and, in some cases, earlier. All of the Latin Armed services—but particularly the six major South American nations with the most highly professionalized military establishments—feel keenly their inability to function with obsolete equipment with attendant impact on service morale and national concepts of sovereignty.

Economic Impact

Military purchases, even of the magnitudes recorded during the peak years of 1967–72 and more recently in 1975 do not appear to have constituted a relatively heavy economic burden to the nations of Latin America. In most instances, military spending is but a small fraction of the national budget and improving economic growth has enabled many countries to spend more for armed forces modernization and upgrading while at the same time increasing civilian consumption and investment levels. Furthermore, the impact of purchases from European suppliers (and in the case of Peru purchases from the Soviet Union) is further mitigated by liberal, if not outright concessionary, credit terms on which such equipment is provided.

Another factor that tends to blur the basic character of Latin American military expenditures is the inclusion of personnel costs such as pay, allowances, housing, medical, retirement, and other nonmateriel expenses. In many instances, defense funds are earmarked for civic action activities in support of the nation-building role of many of the armed forces of the region. Thus, net amounts spent on equipment tend to remain relatively low. In recent years, only Peru (beginning in 1967) has exceeded significantly the regional norm, reflecting the high cost per unit of such equipment as Mirage fighters and AMX tanks. Even large scale acquisitions from the Soviet Union have not influenced substantially the ratio of military expenditures to GNP, largely because of the mitigating factors enumerated.

Despite an apparent large increase in absolute terms, military outlays for the Latin American region as a whole averaged only 2.3 percent of GNP during the last decade, a period which included the peak buying years. This norm is not appreciably greater than prevailed in the previous decade. Measured against this standard, Colombia averaged the least, at 1.4 percent of GNP, while Peru significantly exceeded the norm with a ten-year average of 3.4 percent. Even though spending for armaments and related services has quadrupled since 1940, the overall historic trend of Latin American military expenditures continues to demonstrate the same basic pattern it has held for over 30 years—substantially less than 3 percent of gross national product expanded on military related purchases—the lowest level of military spending in any region of the world today except for sub-Sahara Africa. Much of this fourfold increase in military expenditures is attributable to steadily rising personnel and other fixed costs and increased unit costs of equipment, a consequence not only of more advanced designs but of inflationary factors as well.

Prospects

Despite what would appear to be heavy emphasis on replacement of equipment, the military establishments of Latin America still have sizeable inventories of aging and obsolescent materiel. Hopelessly outdated and often impossible to maintain, this equipment will need to be replaced, or at least rehabilitated, over time. Often it proves far more cost effective simply to replace these units with new production, higher costs of which are somewhat offset by savings realized by reducing the logistical problems inherent in older equipment. But efforts at modernization whether through upgrading of present inventories or through complete replacement will be costly. Inexpensive surplus U.S. equipment is no longer readily available and new production from any source is expensive. Advanced technology, increased raw material costs, and inflation have combined to send prices of new armaments skyrocketing.

In spite of persistent pressure to renew or replace outdated equipment, and indeed, in the case of oil producing countries, more resources with which to acquire modern weaponry, the institutional needs of the major armed forces of the Hemisphere are still rather modest and, once met, should remain relatively stable for the rest of the decade, although substantially above the levels of the late 1960's. Whether needs will again reach the highs of 1975 is problematical. Although the likelihood of overt external threat in Latin America is minimal and should not of itself be a major factor leading to any sudden departure from the norm, Latin American perceptions of, and reactions to, the recent Cuban involvement in Angola have produced a measure of real concern which could translate into increased demand for purchasing defensive armaments. These, however, could be limited by the fact that concessionary credit terms probably will not be so readily available from European suppliers as heretofore, especially as new and more lucrative markets open up in the oil rich regions of the world.

A combination of new found wealth coupled with the perceived threat of Cuban adventurism could generate pressures for renewed spending for upgrading and expanding military establishments. There has been, and will continue to be, no shortage of suppliers willing to meet such demands, even if not on so concessionary a basis as in years past. Such a move toward increasing military expenditures could, in turn, create regional pressures that individual countries might find hard to withstand. Taken as a whole, however, Latin America appears to be generally following its historic arms expenditure pattern and although there may be periodic aberrations, even including another peak as high as 1975, should continue to do so for the balance of this decade.

DEFENSE EXPENDITURES AS A PERCENT OF GROSS NATIONAL PRODUCT, 1965–1975

Country	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975*
Argentina	1.9	2.2	2.0	1.9	1.9	1.9	1.6	1.5	1.4	1.6	1.7
Brazil	2.3	2.5	2.7	2.4	2.4	2.7	2.6	2.3	2.0	2.0	2.0
Chile	2.1	2.3	2.1	2.2	2.1	2.2	2.8	2.8	2.0	3.1	2.9
Colombia	1.7	1.7	1.5	1.5	1.3	1.3	2.5	1.3	1.2	1.0	1.0
Ecuador**									2.0	1.8	1.8
Peru	2.9	2.7	3.5	3.9	3.4	3.8	3.8	3.4	3.7	3.4	3.2
Venezuela	2.3	2.3	2.5	2.2	2.1	2.0	2.4	2.1	1.9	NA	1.8
Six-country average	2.2	2.3	2.4	2.3	2.2	2.3	2.6	2.2	2.0	NA	2.0

Ten-year average—2.3

* Data for 1975 based on preliminary estimates.

** Inclusion of Ecuador since 1973 does not alter the basic trend of Latin American defense spending and reflects the historic ratio despite the relatively large expenditures for this period.

Source: Department of State.

APPENDIX C

NAC EVALUATION OF LOANS BY INTERNATIONAL DEVELOPMENT LENDING INSTITUTIONS IN FISCAL YEAR 1976

Procedures

During Fiscal Year 1976, the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the Inter-American Development Bank (IDB) and the Asian Development Bank (ADB) authorized economic development loans totaling $8.7 billion.[1] (See Table C–1 below.)

The managements of these institutions prepare documentation in support of each loan proposal which is made available to Council member agencies and other agencies participating in the work of the Council, for review in accordance with the procedures and policy criteria summarized in Appendix C of the Fiscal Year 1973 Annual Report of the National Advisory Council.[2]

The result of Council review of loan proposals by the international development lending institutions is an advice to the Secretary of the Treasury of the Council's recommended instructions to the U.S. Executive Directors on the positions they will take in their respective Board meetings. During Fiscal Year 1976, the Council recommended—and the Secretary of the Treasury so instructed—that the United States abstain from voting, or vote negatively, on a few proposed transactions of the international development lending institutions. (These abstentions and negative votes are tabulated in Table C–2 below.[3])

Loan Descriptions

This appendix also provides a brief description of each development loan approved during fiscal 1976 by the World Bank (the International Bank for Reconstruction and Development and the International Development Association), the Inter-American Development Bank, and the Asian Development Bank. These descriptions are arranged alphabetically by recipient country and by lending institution and provide basic information such as the purpose of the loan, loan terms, the identity of the borrower, calculated economic and financial rates of return (when applicable) and the date the loan was approved.

There is also a short survey of the economic or social background factors relevant to the decision to make the loan, and the means by which the loan is expected to benefit the people of the borrowing country. When a loan is of such character that its effects can be estimated directly in terms of the number of people, or families, benefitted (e.g., number of new students to be accommodated in classrooms financed under an education loan, number of family residences receiving new water and sewer under a water supply loan, number of new family housing units under a housing loan) such data is also provided.

In other cases, the nature of the loan may be such that its benefits are spread generally throughout a country's economy and only indirectly reach individuals (e.g. infrastructure projects such as highway construction and maintenance and electric power loans to help expand existing metropolitan systems). The loan descriptions recapitulate these expected general economic effects with benefits to individuals being considered implicit therein, including widened employment opportunties in industry and agriculture made possible by new or improved infrastructure or by the availabilty of resources for capital improvements.

It should also be noted that loans involving

[1] This total does not include the operations of the International Finance Corporation or export credit financing providing by the Inter-American Development Bank.

[2] H. Doc. No. 93–198.

[3] For similar information with respect to fiscal years 1972–1975, inclusive, see H. Doc. No. 94–348, page 94.

the creation of physical facilities have substantial direct short-term benefits in the form of employment opportunities during the construction phase. The level of construction activity financed in part by the international development lending institutions is frequently an important catalytic element in sustaining employment and income, particularly in smaller economies.

TABLE C–1.—*Economic development loans authorized by international development lending institutions, by area, July 1, 1975 to June 30, 1976*

[In millions of dollars]

Area, country	IBRD	IDA	IDB	ADB	Total
Eastern Africa:					
Botswana	16.3				16.3
Burundi		12.7			12.7
East African Community	15.0				15.0
Ethiopia		27.0			27.0
Guinea		14.0			14.0
Kenya	118.0				118.0
Lesotho		5.5			5.5
Madagascar		27.6			27.6
Malawi	9.2	11.6			20.8
Mauritius	7.5				7.5
Rwanda		9.5			9.5
Somalia		23.2			23.2
Sudan	20.0	20.0			40.0
Tanzania	15.0	45.0			60.0
Zaire		42.5			42.5
Zambia	15.0				15.0
Total	216.0	238.6			454.6
Western Africa:					
Benin		9.0			9.0
Cameroon	19.3	18.0			37.3
Chad		5.0			5.0
Congo	38.0				38.0
Gambia		8.1			8.1
Ghana	63.0	10.0			73.0
Ivory Coast	56.6				56.6
Liberia	33.3	6.0			39.3
Mali		10.0			10.0
Mauritania		8.0			8.0
Niger		31.5			31.5
Senegal	21.6	12.5			34.1
Sierra Leone		7.3			7.3
Togo	60.0	9.5			69.5
Upper Volta		9.4			9.4
Total	291.8	144.3			436.1
East Asia and Pacific:					
Burma		37.5		77.3	114.8
Fiji	17.0				17.0
Hong Kong				20.0	20.0
Indonesia	517.0			124.8	641.8
Korea	325.0			135.0	460.0
Malaysia	103.5			46.4	149.9
Philippines	268.0			119.0	387.0
Singapore				23.6	23.6
Thailand	228.0			112.1	340.1
Western Samoa				1.4	1.4
Total	1,458.5	37.5		659.6	2,155.6

See footnote at end of table.

TABLE C-1.—*Economic development loans authorized by international development lending institutions, by area, July 1, 1975 to June 30, 1976*—Continued

[In millions of dollars]

Area, country	IBRD	IDA	IDB	ADB	Total
South Asia:					
Afghanistan		35.0		10.8	45.8
Bangladesh		187.1		21.6	208.7
India	210.0	684.0			894.0
Nepal		34.0		16.8	50.8
Pakistan	50.0	121.6		144.0	315.6
Sri Lanka		25.0		30.0	55.0
Total	260.0	1,086.7		223.2	1,569.9
Europe, Middle East, and North Africa:					
Algeria	150.5				150.5
Cyprus	6.0				6.0
Egypt	157.0	65.0			222.0
Greece	70.0				70.0
Ireland	30.0				30.0
Jordan		10.0			10.0
Morocco	150.0				150.0
Portugal	36.0				36.0
Romania	170.0				170.0
Syria	63.0				63.0
Tunisia	56.9				56.9
Turkey	210.5				210.5
Yemen Arab Republic		23.5			23.5
Yemen, People's Democratic Republic of		10.2			10.2
Yugoslavia	242.0				242.0
Total	1,341.9	108.7			1,450.6
Mexico, Central America and Caribbean:					
Barbados			9.7		9.7
Caribbean Region	20.0				20.0
Costa Rica	39.0		41.5		80.5
Dominican Republic			7.0		7.0
El Salvador	39.0				39.0
Guatemala	14.5		135.6		150.1
Haiti		21.5	38.8		60.3
Honduras	3.0	14.0	26.2		43.2
Jamaica	6.8		27.1		33.9
Mexico	315.0		227.8		542.8
Nicaragua	16.0		16.5		32.5
Panama	12.0		42.2		54.2
Trinidad and Tobago	7.0				7.0
Total	472.3	35.5	572.4		1,080.2
South America:					
Argentina			100.0		100.0
Bolivia	44.5		79.7		124.2
Brazil	498.0		263.0		761.0
Chile	33.0		25.2		58.2
Colombia	80.0		75.8		155.8
Ecuador	51.0		11.1		62.1
Paraguay	4.0	4.0	3.2		11.2
Peru	174.1		69.9		244.0
Uruguay	52.0				52.0
Regional			30.2		30.2
Total	936.6	4.0	658.1		1,598.7
Net totals	4,977.1	1,655.3	1,230.5	882.8	8,745.7

Source: International Bank for Reconstruction and Development, International Development Association, Inter-American Development Bank, and Asian Development Bank.

TABLE C–2.—*"No" Votes and "Abstentions" by the United States in the International Financial Institutions*
[July 1, 1975—June 30, 1976]

Institution	Date	Borrower	Amount ($ millions)	Project	Vote	Reason
IBRD	July 1975	Honduras	3.0	Port	No	Cost Overrun
	December 1975	Algeria	46.0	Cement	No	High Cost
IDA	August 1975	India	110.0	Railroads	No	Long Amendment [1]
	August 1975	India	40.0	Water Supply	No	Long Amendment [1]
	December 1975	India	105.0	Fertilizer	No	Long Amendment [1]
	December 1975	India	4.0	Forestry	No	Long Amendment [1]
	January 1976	Afghanistan	10.0	Agriculture	Abstain	Cost Overrun
	January 1976	India	150.0	Power	No	Long Amendment [1]
	January 1976	India	18.0	Cotton Development	No	Long Amendment [1]
	February 1976	India	200.0	Industrial Imports	No	Long Amendment [1]
	March 1976	Benin	9.0	Roads	Abstain	Cost Overrun
	March 1976	Cameroon	15.0	Roads	Abstain	Cost Overrun
IDB	June 1976	Chile	21.0	Industrial Credit	No	Harkin Amendment [2]
ADB	September 1975	Nepal	0.5	Jute Development	No	Cost Overrun
	November 1975	Burma	6.1	Power Transmission	Abstain	Cost Overrun
	December 1975	Nepal	2.5	Power Transmission	Abstain	Cost Overrun
	June 1976	Afghanistan	10.8	Agriculture	No	Cost Overrun

[1] P.L. 93–373 requires the United States Governor in IDA to vote against any utilization of IDA funds for the benefit of any country which develops any nuclear explosive device, unless the country is or becomes a State Party to the Treaty on the Non-Proliferation of Nuclear Weapons.

[2] P.L. 94–302 requires the United States Executive Director in the IDB to vote against assistance to any country which engages in a consistent pattern of gross violations of internationally recognized human rights unless the assistance directly benefits the needy people in such country. Although this loan was approved by the IDB Board in June it did not become effective until September 1976.

Source: Treasury Department.

WORLD BANK

(International Bank and International Development Association)

AFGHANISTAN

POWER: These loan funds will help purchase and install in the Kabul area a gas turbine power station of the package type, with two units of about 20 MW each, to improve the power balance and to meet the growing demand of the Kabul electric system. Personnel training for operation and maintenance of the power station facilities would also be provided.

Borrower: Afghanistan, DA Afghanistan Breshna Moassessa (DABM).

Loan: $10.0 million; 50 years at 0.75 percent per annum. Total project cost: $11 million.

Purpose and Benefits: An analysis of other alternatives indicated that in the available time frame a gas-turbine installation of about 40 MW capacity would be the only feasible solution to meeting system needs until 1980/81, by which time additional studies for storage hydro projects, or indigenous-fuel based thermal, could be completed and an optimum development program selected. After 1980/81 the plant is expected to be used for meeting system peaking demand. In view of the possibility that the gas turbine plant would be required to generate substantial amounts of energy after 1978/79 in dry periods, the consultants suggested that the gas turbines be equipped for future addition of a 20-MW combined-cycle steam turbine, which would reduce the average operating costs; the proposed project includes provision for such possible future addition. The project, by providing complementary thermal capacity to augment the predominant hydro system, would permit serving additional load with a reliability at least equal to that of the existing system. The internal financial rate of return of the project has been calculated as 7.1 percent. There are operating advantages which, although not quantifiable, are important, such as providing alternative capacity during maintenance outages and frequent breakdowns of some of the existing hydro plants. The project also includes a technical assistance program with other donors, which is expected to yield substantial institutional improvements and ultimately result in a better performance of the power sector as a whole.

Date approved: May 4, 1976 (IDA)

AGRICULTURE: The project aims at raising export earnings from meat and livestock by-products through utilizing the facilities of the livestock slaughterhouse built under the first project and by providing additional market outlets to producers through the development of Sheep Improvement Centers. The project will also increase the supply of meat on the local market and improve the sheep flocks and incomes of nomadic and semi-nomadic flock owners through increased forage production and the creation of an effective animal health service to all producers in the project area, including those in the first project. The project also aims at creating pilot primary cooperatives for small livestock producers who, because of their smallness, are unable to take advantage of institutional credit facilities.

Borrower: Afghanistan, Herat Livestock Development Company (HLDC).

Loan: $15 million; 50 years at 0.75 percent per annum. Total project cost: $18 million.

Purpose and Benefits: The financial rates of return for the on-farm development component of the project range from 11 percent for the nomadic group settlement to 31 percent for the develpment of cooperative member smallholdings. The economic rate of return on the proposed project is estimated to be 16 percent. Production benefits directly attributable to the project would add to annual production some 730 tons of meat, 1,300 tons of milk, 120 tons of wool and 5 tons of hair, with incremental gross sales of $1.4 million per annum. Through the provision of credit and technical services, the project as a whole would directly benefit about 1,050 families (smallholders and semi-nomads), or approximately 10,000 individuals whose average per capita income of $34 is 29 percent below the absolute poverty income level of $44. The average on-farm development investment per family under the project would provide about 700 new jobs on HLDC and on traditonal sector farms.

Date approved: June 24, 1976 (IDA)

ALGERIA

INDUSTRY: The project includes: (a) construction of a 500,000 tons per year cement plant at Saida; (b) expansion and reorganization of the Societe Nationale des Materiaux de Construction (SNMC) distribution system; and (c) technical assistance to the Societe Nationale de Comptabilite (SNC), the state enterprise responsible for auditing and accounting.

Borrower: Societe Nationale des Materiaux de Construction (SNMC).

Loan: $46 million; 15 years at 8.5 percent per annum. Total project cost: $98 million.

Purpose and Benefits: The most important benefits of the project will be derived from "institutional" assistance to SNMC in coping with the present and future organizational, marketing, and financial problems created by a two billion dollar investment program. The Saida plant will help to alleviate the bottleneck in the supply of construction materials and contribute to employment and development in the rural plateau region. The distribution component of the project represents a necessary complement to SNMC's ongoing expansion of production facilities; its benefits derive from SNMC's urgent need for a reorganization of its distribution function and to develop an adequate transport and marketing strategy within the next two years. The technical assistance to SNC is an integral part of the project's effort to strengthen SNMC since SNC will act as SNMC's external auditor. SNC is also expected to assist SNMC in strengthening its cost control, budgeting, financial planning and accounting methods. However, the major benefit of the SNC program will be the improvement of accounting and auditing practices in Algerian enterprises. The economic rate of return is estimated to be 10.3 percent.

Date approved: December 16, 1975 (IBRD)

INDUSTRY: The objectives of this project are to: (i) establish a new Technological Institute which would be instrumental in meeting the need for engineers and middle-level technicians in fields which are of crucial importance for the development of modern industries relying on power and process control systems; and (ii) provide

ALGERIA—Continued

much needed technical assistance to support the planned introduction of universal "Fundamental Education" and the reform of general secondary education; (iii) provide the framework for rational development of vocational training; and (iv) assist the ongoing reform of higher education in the fields of education management and teaching technologies.

Borrower: Democratic and Popular Republic of Algeria, Ministry of Industry.

Loan: $47 million; 20 years at 8.5 percent. Total project cost: $78 million.

Purpose and Benefits: By increasing the annual output of the system by about 190 engineers and 440 middle-level technicians specialized in various fields of electrical and electronic engineering, the project would provide about 50 percent of the projected average annual demand for this type of skills in the early 1980's—thus assisting in alleviating manpower shortages which could seriously impair the planned development of the industrial sector, and more specifically of sub-sectors such as large scale food processing, power generation, telecommunications, mechanical and electrical products which all rely heavily on modern power and process control systems. At the same time, the project would provide an essential input of technical assistance for the planning, preparation and execution of important reforms at all levels of education which, if properly implemented, could result in drastic improvements in the quality and relevance of basic education, more equitable distribution of educational opportunities through the progressive generalization of "fundamental education" to all Algerian boys and girls, better adaptation of secondary education to the country's needs and priorities, and improved educational efficiency at post-secondary level.

Date approved: February 10, 1976 (IBRD)

POWER: The project consists of the transmission component (including substation, transmission lines and dispatching) of the borrower's 1976–1980 investment program plus studies for the development of Societe Nationale de l'Electricite et du Gaz (SONELGAZ) and the modernization of its organization. The project comprises the following: 1,440 km of 220-kV transmission lines; 1,380 km of 90 and 69-kV transmission lines; 560 km of 30-kV lines; 1,100 MVA of 220/60-kV substations; 3,125 MVA of 60/30kV substations; and a dispatch system comprising one main dispatch center and three district dispatch centers, and related studies. The program also includes about 1,720 MW of generating capacity, distribution works, and training of engineers and technicians in foreign universities.

Borrower: Societe Nationale de l'Electricite et du Gaz (SONELGAZ).

Loan: $57.5 million, 15 years at 8.85 percent per annum. Total project cost: $575 million.

Purpose and Benefits: SONELGAZ is undertaking an investment program comprising a gas/turbine component of 250–300 MW in 1978/79 followed by a steam plant, as the least cost solution to meet the forecast power requirements. Since the project is an integral and essential part of the overall investment program, the estimated rate of return is slightly less than 20%. The trend growth of electricity consumption since 1966 has been 11.5 percent per year, and is projected to continue, over the 1974–1980 period at around 15.3 percent. The relatively high growth rate is in accordance with the rapid industrial expansion planned by the Government. The share of sales to industry is expected to increase from about 45 percent in 1974 to 57 percent in 1980.

Date approved: June 22, 1976 (IBRD)

BANGLADESH

INDUSTRY: The loan funds will make available foreign exchange for the import of industrial components, chemicals, raw materials, spare parts and packing materials to enable selected high priority industries, with particular emphasis on jute and textiles, to maintain or expand production.

Borrower: People's Republic of Bangladesh.

Loan: $100 million; 50 years at 0.75 percent.

Purpose and Benefits: The need for non-project assistance to Bangladesh rests primarily on: (a) the magnitude of, and urgency for, foreign aid disbursements to provide for imported raw-materials, spares and components for increasing industrial production and the utilization of existing capacity; (b) the difficulty of achieving aid disbursements on the scale required through appropriate projects; and (c) the need to support the introduction in the jute and cotton textiles sectors of action programs designed to improve output, reduce production costs and increase overall efficiency. The credit would help provide the Government with the flexibility needed to implement the monetary and fiscal program initiated in recent months in conjunction with a Standby Agreement with the IMF. The Government's economic stabilization program is focused on reducing inflation and improving domestic resource mobilization in order to maintain a shift in the orientation of public expenditure towards development. In the Letter of Intent exchanged with the IMF in July 1975, the Government expressed its intention to adhere strictly to credit ceilings and avoid inflationary financing in 1975/76, to improve the financial performance and economic efficiency of public sector corporations and to increase planned development expenditure. In conjunction with a devaluation of the Taka by 58 percent in May 1975, the Government abolished export subsidies and multiple exchange practices and introduced a partial liberalization of import controls. The tariff structure has been rationalized and the scope of activities of the State Trading Corporations reduced in recent months.

Date approved: October 28, 1975 (IDA)

AGRICULTURE: This project would provide irrigation, flood control and drainage, improvement of navigation for country boats and agricultural inputs in the Halda and Ichamati Units, About 840 units of 7–10 hp diesel-powered low-lift pumps, each serving an average area of 45 acres, would irrigate the area from an extensive network of natural and project-improved channels. In the Halda Unit, the channel system would be supplied by tidal recharge, whereas in the Ichamati Unit it would be by a main pumping plant. In both areas, high-level channels would be filled by relift pumping stations. Both project areas would be protected from outside flooding by perimeter embankments and regulators on the channels. The Ichamati pumping plant would serve to drain excess water in the unit during the wet season. Channel excavation and the regulators would make navigation by small boats possible in most parts of the project area.

Borrower: People's Republic of Bangladesh, Bangladesh Water Development Board.

Loan: $22.0 million; 50 years at 0.75 percent. Total project cost: $30.3 million.

Purpose and Benefits: The primary benefits from the project would be a 50 percent increase in rice production, from the present 93,000 tons of paddy to 141,000 tons at full development in 1983. At the projected world market price for milled rice of $250 per metric ton cif Chittagong, the project's economic rate of return would be about 15 percent. The net foreign exchange savings from rice imports would be around $3.3 million (in 1975 dollars) annually. The project would lead to increased income for 20,000 farm families, most of whom are very small farmers operating on an average of about 1.6 ac. Average farm income would increase from about $90 to about $120 per capita per year. The demand for hired labor would also increase substantially and thereby create additional employment opportunities for landless laborers and "marginal" farmers.

Date approved: January 20, 1976 (IDA)

AGRICULTURE: The project is the first phase of a program to increase agricultural production by bringing farmers more effective extension, cooperative and credit services. It involves expansion of training programs for extension and rural development staff and studies and pilot programs to determine methods of improving the effectiveness of the extension and rural development efforts at the local level. The Credit would finance: (a) construction, furnishing and equipment for: a graduate level inservice training unit at the Bangladesh Agricultural University (BAU) for training officers engaged in rural development and teachers at extension institutes, three new Agriculture Training Institutes (ATIs) and the expansion of four existing institutes, a Regional Academy of Rural Development at Bogra, and experimental facilities (Thana Training Units and Thana Sub-stations) in 15 thanas to try new modes of farmer training on a pilot basis: (b) in-service training for present extension personnel; and (c) technical assistance and training programs.

Borrower: People's Republic of Bangladesh.

Loan: $12 million; 50 years at 0.75 percent per annum. Total project cost: $16.5 million.

Purpose and Benefits: The project would economize on resources through coordination of rural training policies, increase the coverage of trained extension workers, provide immediate intensive in-service training in high yielding varieties (HYV) rice technology to extension officers, and would enable the Government to increase substantially its trained credit and cooperative staff. The project includes a number of studies (including evaluation) and technical assistance activities, which should permit close monitoring of progress in the implementation of the project. This close follow-up should enable the Project Implementation Unit and the National Committee on Rural Training, to identify problems early and provide quick remedial actions.

Date approved: March 18, 1976 (IDA)

TECHNICAL ASSISTANCE: The funds from this credit will be allocated to specific subprojects, primarily for feasibility studies and other investigations required for preparing projects for financing by the Association. The proceeds will also be used for strengthening institutions responsible for project planning and implementation (through the provision of management assistance or staff training), for more general studies which may be required prior to the preparation of specific projects, and for the preparation of projects for financing by other agencies. Special emphasis would be placed upon staff training programs designed to improve Bangladesh's project preparation capacity.

Borrower: People's Republic of Bangladesh.

Loan: $7.5 million; 50 years at 0.75 percent per annum. Total project cost: $8 million.

Purpose and Benefits: While bilateral agencies and the United Nations Development Program (UNDP) are expected to continue providing much of Bangladesh's requirements for technical assistance, the levels of need are beyond what can be expected from these agencies over the next two years. It is therefore necessary for IDA to continue lending for technical assistance, especially since this has proved to be essential for the total lending program. It improves the project pipeline not only for IDA financing but also for financing by other donors.

Date approved: April 6, 1976 (IDA)

INDUSTRIAL CREDIT: This project will help finance the foreign exchange cost of industrial projects carried out by eligible productive enterprises in Bangladesh. The Government of Bangladesh (GOB) will relend to the Bangladesh Shilpa Bank (BSB) at 9 percent while BSB will onlend to sub-borrowers at 12 percent. Exchange risks will be borne by sub-borrowers.

Borrower: People's Republic of Bangladesh (GOB), Bangladesh Shilpa Bank (BSB).

Loan: $25 million, for 50 years at 0.75 percent per annum.

Purpose and Benefits: BSB is likely to require a total of about $44 million to cover its foreign currency financing requirements through 1977. Against this it now has only $3 million equivalent in tied credits from India and $1.25 million equivalent from KfW. A $25 million credit to BSB is recommended to meet part of its foreign currency commitment requirements through calendar 1977. ADB is willing to consider an additional loan of $15 million to BSB once the proposed credit has been substantially committed to fill the balance of BSB's resource gap during this period. This approach provides for an IDA commitment period of only 18 months which is appropriate given BSB's present difficulties.

The objectives of the credit include: (i) stimulating the development of industry, with a consequent favorable impact on employment, incomes and foreign exchange earnings and savings; (ii) helping to create a more favorable policy climate for investment in export-oriented projects; and (iii) helping to restore BSB's credit-worthiness within a reasonable time frame through an agreed program of action to strengthen its soundness and effectiveness as a development bank. The free limit should be set at $150,000 and the aggregate free limit at $6 million. These limits would allow IDA to review about 25 percent by number of the subprojects to be financed by BSB covering at least 76 percent by amount of the total credit.

Date approved: May 20, 1976 (IDA)

RURAL DEVELOPMENT: This project consists of a rural works program (rural road, drains, rural markets, fish ponds), minor irrigation (low-lift pumps, shallow tubewells, hand pumps), thana facilities (office and living quarters of thana officers, cooperative godowns), and strengthening of rural institutions and services (Comilla-type cooperatives, as well as extension animal health services, fisheries and credit facilities).

Borrower: People's Republic of Bangladesh.

Loan: $16 million; 50 years at 0.75 percent per annum. Total project cost: $24.7 million.

BANGLADESH—Continued

Purpose and Benefits: There would be substantial foreign exchange savings (about US$15.0 million per year) through increased rice production (75,000 tons of rice). The project would also help increase the draft animal power supply and production of fish (which forms 80% of the protein supply in the Bengali diet). The cultivators in the project area would benefit from increased farm incomes. One of the most important (and possibly most difficult to attain) aims of the project would be to ensure that the larger farmers would not monopolize the rural institutions supported under the project. Through better operation of the rural institutions, more efficient and equitable distribution of inputs, better and more frequent contact between field workers and farmers, and more credit discipline, small farmers would be expected to become more active in, and benefit more from, rural institutions. The landless laborers and the underemployed marginal farmers would benefit from increased employment opportunities, from intensified agricultural and fishery activities, rural works programs, and secondary services such as transportation, marketing and processing. The rural population in the area would also benefit from improvements in social infrastructure such as village markets and roads. The project's economic rate of return is estimated to be over 40%. The rather high return estimated for this project is due to the fact that in contrast to the conventional capital intensive projects, the primary emphasis in this project is to achieve increased production by promoting practical and better technology (such as rainfed HYV cultivation) through marginal (capital) investments and institutional improvement.

Date approved: May 20, 1976 (IDA)

BOLIVIA

RURAL DEVELOPMENT: The individual project components are: (a) irrigated agricultural development; (b) rainfed agriculture and marketing development; (c) productive support facilities and social infrastructure; (d) health facilities; (e) potable water and waste facilities; and (f) technical services.

Borrower: Republic of Bolivia, Ministry of Agriculture.

Loan: $9.5 million; 25 years at 4.5 percent per annum. Total project cost: $12.8 million.

Purpose and Benefits: The project will help finance agricultural development to increase the income and improve the living standards of about 4,000 subsistence farmers' families in the eastern part of the Province of Ingavi and the southern part of the Los Andes Province in the Altiplano region. In addition, it will finance complementary infrastructure and social services for the benefit of all the 10,000 rural families living in the project area. The best estimate of the project's economic rate of return is 15 percent. In calculating the rate, half of the costs of the health, water supply and the waste systems were included because access to these facilities would increase labor productivity and therefore, would be reflected in greater agricultural output.

Date approved: February 17, 1976 (IBRD)

POWER: This project consists of the following elements: (a) expansion of the Santa Isabel hydroelectric power station, including a third unit (18 MW) and the installation of a second penstock; (b) construction of a compensating pond with a capacity of 100,000 m^3, to be located at the Santa Isabel power station intake and to store water from the Corani power station; (c) collection of water from the two arms of the Vinto River at a maximum discharge rate of 3 m^3/second for diversion to the Santa Isabel tunnel; (d) installation of a gas turbine with a capacity of approximately 22 MW at the Santa Cruz power station; (e) construction of a single circuit 11 KV transmission line, 150 km long, between the Sacaba and Vinto substations; and (f) construction of the Vinto substation, expansion of the Cochabamba and Sacaba substations and installation of shunt capacitors at the Oruro substations.

Borrower: Empresa Nacional de Electricidad, S.A. (ENDE).

Loan: $25 million; 25 years at 8.5 percent per annum. Total project cost: $28.8 million.

Purpose and Benefits: Projections for rapid growth in the ENDE system results, in part, from the anticipated substitution by commercial and industrial consumers of ENDE-furnished power for the power that has been previously supplied by less efficient captive plants. The relatively low cost ENDE-furnished power should facilitate the development of medium and small scale enterprises. The proposed transmission lines in the areas to be served would improve the continuity of service, eliminate supply losses caused by transmission failures and improve voltage control. To cover the increase in demand in the Santa Cruz System, the installation of a third 22 MW turbine is the least cost solution. The existing diesel units in the Santa Cruz plant would be transferred to Sucre in 1976 when the installation of the second gas turbine in Santa Cruz is completed later this year. The rate of return on this project is estimated to be 19 percent, taking expected revenues as a proxy for benefits and assuming that ENDE maintains a 9 percent rate of return on revalued assets.

Date approved: April 6, 1976 (IBRD)

MINING: The loan will help finance the foreign exchange component of projects in the private mining and industrial sectors. The IFC investment will increase the subscribed share capital of the Banco Industrial, S.A. (BISA) directly, and indirectly, by requiring a 2:1 *pari passu* investment from other sources. It is estimated that 70% of loan funds will be used for relending to the private mining sector and 30% to the industrial sector. Loans to small enterprises (less than $50,000 equity and 50 employees) will receive an estimated 10% of the proposed loan.

Loan: $10 million and equity $0.55 million. Repayable substantially in conformity with the aggregate of the amortization schedules for subloans. Interest at 8.85 percent per annum.

Borrower: Bolivia, Banco Industrial, S.A. (BISA).

Purpose and Benefits: Based on an analysis of BISA's list of projects under consideration, it is expected the economic rate of return (ERR) of the mining subprojects to be financed under the proposed loan, like those being financed by the IDA Credit, would exceed 40%. The high ERR is not surprising since most of BISA's mining subloans are for the improvement and expansion of existing mines. ERRs of new operations would be much lower. Projections indicate that the mining subprojects are likely to make contributions to Bolivia's net foreign exchange earnings of about $115 million (net of import requirements) and to government revenues of nearly $50 million, cumulative from inception up to 1985. Production increases are expected to account for about 20% of the output of medium mines and for some 5% of the cumulative mining output of Bolivia over the same period. Due to the need for relatively capital-intensive production methods, direct employment created would be relatively minor, about 650 jobs. Some improvement could be expected in health and safety conditions as a consequence of expansion and modernization of the mines, and in the standard of living of mine workers as a result of associated investment in on-site housing and infrastructure facilities. Scarcity of term credit has continued to be a major deterrent to the growth of the mining and processing industries, in which Bolivia has a comparative advantage. The project, consisting of a Bank loan and an IFC investment, would contribute both directly and indirectly to help fill this major gap in financing. It would provide term financing for private mining and industrial projects, including projects of small industrial enterprises, while at the same time contributing to the further development of BISA as the principal lending institution of the Bolivian private sector. The project would also contribute to the development of the Bolivian capital market by supporting BISA's efforts to mobilize domestic resources through bond issues and additional share capital. Although the amount to be raised is relatively minor, initial success in this activity could break the ground for much larger issues in the future, which could help meet the considerable working capital needs of Bolivian industry.

Date approved: June 22, 1976 (IBRD AND IFC)

BOTSWANA

TRANSPORTATION: The project consists of: (a) the construction of the Caborone-Molepolole road (52 km) to two-lane bituminous standards; (b) consulting services to: i) supervise this construction; ii) prepare detailed engineering for the Mahalapye-Serule road (about 150 km); and iii) carry out a Road Maintenance Study; (c) a District Road Maintenance Pilot Program comprising technical assistance and equipment; (d) strengthening of the Department of Roads through staff training and provision of soils laboratory equipment; and (e) loadmeters and weighbridges and their installation.

Borrower: Republic of Botswana.

Loan: \$5.8 million; 23 years at 8.5 percent. Total project cost: \$7.4 million.

Purpose and Benefits: The Gaborone-Molepolole road serves approximately 4,000 km² and about 60,000 people in the Kweneng District, who are mostly small farmers engaged in cattle-raising and crop cultivation. Gaborone and Molepolole are the major market centers for the area's farm produce. Molepolole, which has small cottage industries and an increasing number of trading establishments, is a gateway to the Kalahari Desert and western Botswana. The Government plans to improve livestock raising practices and marketing in the area, and is constructing the requisite facilities at Letlhakeng which is linked to Molepolole by a recently completed district road. The Kweneng Rural Development Association plans to expand its cottage industries in Molepolole, and in 1974 the District Council approved a proposal to build an industrial estate there. In 1974, mineral exploration in Kweneng resulted in the discovery of substantial coal resources which are likely to become an important factor in the local economy. Also, tourism is expected to increase, principally in the Khutse Game Reserve about 160 km northwest of Molepolole, and the Government plans to develop tourist facilities there. These developments would all be assisted by improving the Gaborone-Molepolole Road. The construction of the road is expected to yield a 17 percent economic return, assuming an economic life of 20 years. The benefits of the other project components have not been quantified; however, it is expected that they will be considerable. The detailed engineering of the Mahalapye-Serule portion of the North-South road is of particular importance, given the rapid growth in mineral, industrial and agricultural developments in the eastern region.

Date approved: November 4, 1975 (IBRD)

EDUCATION: The project consists of: (a) the provision of buildings, furniture and equipment for the following: (i) five new junior secondary schools; (ii) expansion of secondary school teacher training facilities; (iii) expansion of the adult education facilities at the Botswana Extension College to provide a service center to develop materials for radio and correspondence training programs; (iv) expansion of the Botswana Youth Brigade Program including the establishment of a National Brigade Development Center; and (v) one multipurpose education center in the Kalahari area; (b) the cost of professional services, technical assistance and operational expenses for project administration and evaluation as well as for preparation of future education projects.

Borrower: Republic of Botswana.

Loan: \$7.0 million, with a term of 25 years, including seven years of grace and with interest at 8.5 percent per annum; and \$3.5 million for 25 years at 4.5 percent per annum with 7 years grace. Total project cost: \$15 million.

Purpose and Benefits: This project will: (i) provide a 30 percent increase in student places at the secondary level; (ii) enable an additional 9,000 adults annually to take radio and correspondence courses; (iii) enable about 500 primary school leavers annually to receive on-the-job skill training; and (iv) provide rural training facilities for about 3,600 youths and adults in the Kalahari Area, which is the most disadvantaged region of Botswana. The principal risk is that the innovative non-formal education features of the Kalahari Multipurpose Educational Center, which would serve as a prototype for further centers in the rural areas, might not achieve full success because its operation depends upon effective cooperation of several ministries. To minimize this risk, the government has established interministerial task forces to develop the adult education programs and the modified secondary school curriculum to be used at the Center. Also, close monitoring of all project items would be done by the evaluation unit. The only other important risk in the project relates to the Youth Brigade Program, which offers an unusual opportunity to provide employment-oriented training for primary school leavers. The success of the Brigades has already been demonstrated and the project would provide needed support for their continued development. However, development in the past has been exclusively through local village initiative, and there is a possibility that government involvement might reduce this initiative. The objectives of the project and its expected benefits point to its suitability as a part of Botswana's overall strategy to improve the productivity of the rural sector, provide amenities for and raise the living standards of the rural population, reduce manpower shortages and gradually replace expatriates, and improve the efficiency of the education sector.

Date approved: May 27, 1976 (IBRD)

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BRAZIL

INDUSTRY: This fifth loan for steel expansion will help the Companhia Siderurgica Paulista's (COSIPA) stage three expansion of its production facilities from about 2.3 to 3.5 million metric tons of raw steel per year to produce about 2.8 million tons of flat products. The new facilities will include a pier and additional raw materials handling equipment, a third sinter plant, a second BOF shop with two 120-ton vessels and two continuous slab casting machines, remotoring of the finishing stands of the hot strip mill, an additional slab reheat furnace for the 4,100 mm plate mill together with an additional cooling bed and normalizing furnace, a new pickling line, a new 5-stand tandem cold reduction mill, a new temper mill, lines for coil inspection, shearing and electrolytic cleaning, and associated maintenance and auxiliary facilities including a new roll shop for the cold mill, high and low pressure boilers, one turbogenerator with substation and a fourth oxygen plant.

Borrower: Companhia Siderurgica Paulista (COSIPA).

Loan: $60.0 million; 15 years at 8½ percent. Total project cost: $1,446.2 million.

Purpose and Benefits: The project will help eliminate massive imports of flat rolled steel products. The new facilities will increase the plant's raw steel capacity, reduce production costs, and improve product quality. COSIPA's selling prices are on the whole slightly below European domestic prices for similar products. Current CIF import prices are somewhat higher than domestic prices and it is expected that, upon completion of the project, the Company could meet substantially lower import prices and still earn an acceptable financial return. Based on projected long-term import prices for steel products over the assumed 18 year life of the assets, the project's rate of return to the economy is estimated to be 16%. Net foreign exchange savings resulting from the project are estimated at about US $230 million per year by 1982. Other external lenders are the Inter-American Development Bank ($40 million) and bilateral sources.

Date approved: July 22, 1975 (IBRD)

TRANSPORTATION: The project consists of a two-year tranche, 1976 and 1977, of the Five-Year 1975–79 Investment Plan for FEPASA—Ferrovia Paulista, S.A. to: (a) provide the very densely populated suburban area of Sao Paulo with a more adequate, more efficient and expanded commuter rail service which in the Sao Paulo area is almost exclusively used by lower income earners; (b) complete construction of about 700 km of new lines and realignments; (c) add about 65 locomotives and 1,800 freight cars to the rolling stock fleet and to modernize about 2,600 freight cars which still have a useful life; (d) rehabilitate and partly renew about 700 km of the track, replace 300 switches and provide the permanent way department with mechanized maintenance equipment; (c) improve various stations, yards and workshops; (f) renew about 300 km of overhead wire and electrify 86 km of line; (g) install 211 km of centralized traffic control (CTC) and replace about 1,800 km of telephone lines; and (h) do feasibility studies and final engineering; provide technical assistance in the fields of project management and control, train and station operations, permanent way, information and data processing; and other studies in preparation for future investments.

Borrower: FEPASA—Ferrovia Paulista, S.A.

Loan: $75 million; 25 years at 8.5 percent. Total project cost is $366.7 million.

Purpose and Benefits: FEPASA's planned investments in these suburban services are a component of the least cost solution to the mass transport problem of the Sao Paulo metropolitan area. FEPASA's suburban railways serve some of the poorest sectors of Metropolitan Sao Paulo and the facilities are at present antiquated and seriously overcrowded. Passenger traffic on FEPASA's lines is expected to increase fivefold by 1985. The investments in the Plan will improve the operating efficiency of the FEPASA system and expand its capacity to meet the future demands of traffic. The overall economic rate of return for the total Investment Plan is estimated at 21 percent.

Date approved: October 21, 1975 (IBRD)

AGRICULTURE: The project includes: (a) an expansion and improvement of extension services through the addition of agricultural advisors especially trained to deal with small farmers' problems; the provision of logistical support; and an increase in the number of social extension workers; (b) the provision of additional credit to small farmers for on-farm investment and seasonal production purposes; the testing of alternative, simplified lending procedures for small loans; and the application of a parallel program of crop insurance for farmers; (c) experimentation and farm trials to improve technical packages for cotton and other crops; (d) the expansion of rural health services and the strengthening of supervision and referral systems; (e) the training of project staff and development of training materials for farmers; (f) organizational support for project administration, monitoring and evaluation, and a project special fund for miscellaneous project activities; and (g) the preparation of future rural development projects in other areas of the state.

Borrower: The Federative Republic of Brazil, Banco do Brasil, S.A. Banco do Nordeste do Brazil, S.A.

Loan: $12.0 million; 25 years at 8.5 percent per annum. Total project cost: $30 million.

Purpose and Benefits: This rural development project in the Northeast is strengthening the Government's program to increase the income and welfare of poor farmers. Farmer benefits will arise principally from increased cotton production, largely through increased yields but also as a result of a minor expansion of the cultivated area. Further benefits will derive from increases in the production of subsistence crops (corn, beans, sorghum) through gradually improved varieties and cultivation practices; and from improved health and social services. On the average, net cash income per family from cotton production (which averages about 70 percent of net cash income per farm) on farms up to 50 ha would increase from about US$210 now to about US$430 at full development; on farms of 50–200 ha the increase would be from US$590 to US$1,200. Further cotton production benefits could be expected on farms larger than 200 ha which, while not the focal point of the project, would benefit from the results of research and improved extension. The project would provide a modest increase in employment in the project area in addition to reducing underemployment. On smaller farms much of the increased labor requirement would be met by family labor. Nevertheless, the equivalent of approximately 2,200 new jobs would be created. The overall economic rate of return is estimated to be 15 percent.

Date approved: December 11, 1975 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: This Bank loan is made to the Government of Brazil, which would make available the proceeds of the loan to the National Bank for Economic Development (BNDE) on the same financial terms and conditions as the Bank loan, and BNDE would assume the foreign exchange risk. BNDE would relend the proceeds of the loan to 22 state and regional development banks, and they in turn will relend the funds to small and medium industries. The loan proceeds would be used to finance part of the foreign exchange component of fixed assets and working capital of investment projects carried out by small and medium industries and the foreign exchange cost of technical assistance to BNDE. Subloans would be denominated in cruzeiros with monetary correction, and would carry regionally differentiated interest rates.

Borrower: The Federative Republic of Brazil, Banco Nacional do Desenvolvimento Economico (BNDE).

Loan: $85 million; 12 years at 8.5 percent per annum. Total project cost is $600 million.

Purpose and Benefits: Besides supporting BNDE's institution-building effort, the loan would assist a segment of industry which traditionally has been hindered by difficult access to term-financing. The project's expected employment benefits would be sizeable as it would help increase the sub-borrowers' labor force by 60 percent, which would correspond to the creation of an estimated 40,000 new jobs at an average investment cost of about $15,000 equivalent per job. Modernization of production facilities and techniques would also help upgrade skills of trained and untrained labor. Support of small and medium industries will also help to stimulate entrepreneurship, help balance the ownership distribution of productive assets and foster regional decentralization of industry.

Date approved: February 10, 1976 (IBRD)

TRANSPORTATION: This project consists of (a) a program of construction, rehabilitation or improvement of secondary and feeder roads linking existing agricultural areas to federal and state primary highway networks, and the construction, under certain conditions, of penetration roads into new areas with good economic and agricultural prospects; and (b) consulting services for engineering studies and subproject supervision. The project would be financed by a line of credit extended through the Government to the National Bank for Economic Development (BNDE) for onlending to state highway departments and municipal consortia for subprojects to be selected according to agreed criteria. The National Highway Department (DNER) would provide assistance in the technical evaluation of proposals. The proposed project would encompass BNDE's total program of lending for feeder roads for the 1976–79 period.

Borrower: Federative Republic of Brazil.

Loan: $55 million, 16 years at 8.5 percent per annum

Purpose and Benefits: The project will have a positive impact on agricultural production. Improved access from rural areas and communities to the rest of the country would contribute to agricultural development by (i) reducing operating costs and achieving economies of scale resulting from the use of heavier vehicles, with the cost savings being transmitted principally to producers and consumers; (ii) reducing risk and uncertainty to farmers by providing more reliable all-weather access to markets, storage and processing facilities, and by allowing farmers to shift production to some perishable products when demand and supply conditions are appropriate; and (iii) facilitating access to essential farm inputs such as fertilizers, seeds, insecticides and to Government credit and extension programs for the agriculture sector. The proposed roads would also produce significant benefits from road user saving accruing to existing traffic.

Date approved: February 10, 1976 (IBRD)

AGRICULTURE: This project includes the execution of agricultural research programs on rice, maize/sorghum, cassava, cotton, beans, rubber, dairy cattle, beef cattle and sheep/goats and on farming-systems in the Northeast, North and Center-West of Brazil. Project components include: (a) a program of civil works to build, expand or improve the experiment station buildings and facilities at two of three Agricultural Research Center sites, five of the eight National Commodity Center sites and all fourteen of the state level research station sites at which the project will be executed; (b) the procurement of laboratory and farm equipment and vehicles for the different stations; (c) the development of research plots, including initial and preparation and the installation of irrigation systems as neccessary; (d) the purchase of land for several of the sites not yet Government-owned; (e) the provision of a technical assistance program including the equivalent of some 60 man-years of longer term (one to five years) consulting services and 41 man-years of shorter-term services; (f) a fellowship program for the training over a five-year period, in Brazil and overseas, of 123 Brazilian Agricultural Research Corporation (EMBRAPA) staff to the Ph.D. level and 663 to the M.Sc. level; and an in-service program of short course training for an additional 180 staff members; and (g) the incremental salary and research operating and materials costs over the five-year project period.

Borrower: Brazil, Brazilian Agricultural Research Corporation (EMBRAPA).

Loan: $40 million; 20 years at 8.5 percent per annum. Total project cost is $189 million.

Purpose and Benefits: The project will have a major impact in strengthening the organization and production orientation of Brazil's agricultural research system. This would help EMBRAPA to consolidate a multiplicity of previously existing research stations, to reduce duplication among research efforts, to assure continuity in research planning and execution, and to develop an effective collaboration between extension and research services to ensure that research results benefit a broad range and large number of farmers. Particularly in the Northeast, most of the potential project beneficiaries are in the lowest income groups. For example, there are 1,600,000 small-scale farm units of less than ten ha where per capita incomes are virtually all below the relative poverty level (defined for Brazil as roughly $225 in 1974). A majority of families operating the some 860,000 farm units of over ten hectares are also in this poverty group.

Date approved: April 27, 1976 (IBRD)

INDUSTRY: The project consists of the construction of an ammonia plant at Araucaria, Parana, with a manufacturing capacity of about 1,200 metric tons per day, including an air separation plant and facilities to store about 5,000 metric tons of ammonia; an adjacent plant to manufacture urea, with a capacity of about 1,500 metric tons per day, including facilities to store about 30,000 metric tons of bulk and bagged urea; a sulfur recovery unit with a capacity of about 58 metric tons per day; and related ancillary facilities. The project also includes construction and equipment of the necessary laboratories, offices and maintenance shops.

BRAZIL—Continued

Loan: $50 million; 15 years at 8.5 percent per annum. Total project cost: $272 million.

Borrower: Petrobras Fertilizantes, S.A.

Purpose and Benefits: The annual economic value of the project's output of about 292,000 TPY of nitrogen is estimated at US$107 million in constant 1975 dollars, and the economic rate of return at 24%. The project's economies of scale, its use of a relatively inexpensive feedstock, and its import substitution role account for the favorable rate of return.

Date approved: May 11, 1976 (IBRD)

POWER: The project consists of the construction, installation and improvement of subtransmission, distribution and auxiliary service facilities, and consultant services and training. The main features of the project are: (i) installation of 216 circuit-km of 138 kV and 69 kV lines; 2,030 km of 34.5 kV and 13.8 kV lines; 775 MVA of transformer capacity at 138 kV, 69 kV, and 34.5 kV; 4,760 transformers with a total of 260 MVA capacity; 220,000 household electric meters and 135,000 street lights; (ii) acquisition and utilization of energized-line maintenance and system protection and operation equipment; and (iii) inspection of equipment fabrication through the utilization of consultants' services, and training of staff during such inspection. The project is expected to be completed by June 30, 1979.

Borrower: Federative Republic of Brazil, Companhia Paranaense de Energia Eletrica (COPEL).

Loan: $52 million; payable in 20 years, including 3½ years of grace and 8.5 percent per annum. Total project cost: $188 million.

Purpose and Benefits: The project will enable COPEL to meet growing service requirements in its concession area, while improving efficiency and reliability through reduction in losses and outages and better voltage regulation. About 141,000 new consumers, including 20,000 low-income households in the main cities of Parana will be connected to the statewide system. The rate of return on the overall investment program has been estimated to be 20 percent. This indicates that the average price that consumers will pay for power will be considerably in excess of incremental system costs, and that wasteful use of electricity and unnecessary investment will be avoided.

Date approved: May 11, 1976 (IBRD)

NUTRITION: This project consists of: (a) the development of an information base through a nutrition and food consumption survey and surveillance system, and a continuing program of assessment of nutritional implications of agriculture policies; (b) the testing of alternative nutrition delivery systems, including the rural extension service, school feeding system, urban and rural health delivery systems, and commercial markets; (c) the development and production of low-cost nutritious foods; and (d) a program of institutional development, including the training of project staff and development of training capability; and organizational support for project management, planning, monitoring and evaluation.

Borrower: The Federative Republic of Brazil, National Food and Nutrition Institute (INAN)

Loan: $19 million; payable in 18 years at 8.85 percent per annum. Total project cost: $71.9 million.

Purpose and Benefits: In the process of carrying out the tests for the long-range purposes stated, the health and performance—both short and long-run—would be improved for approximately 110,000 young children and, relatedly, pregnant and lactating women from low-income families who would benefit directly from food supplementation and/or other nutrition services; school attendance, performance and subsequent productivity would be increased for older children and productivity of a substantial, but indeterminate, portion of the low-income labor force (and their families) would increase through consumption of low-cost processed nutritious foods made possible by the project; increased food production, lower food losses, increased on-farm consumption and related increased productivity would take place among families of 3,000 small farmers in Northeast Brazil; the productivity and well-being of an undetermined but substantial portion of the low-income population would be enhanced from improved diets made possible by the modification of agricultural policies which would be expected to incorporate consideration of nutritional implications; and small- and medium-sized industries, traditionally hindered by difficult access to term financing (particularly foreign exchange), would be given the opportunity to carry out needed capital investments to improve production facilities and increase productivity. An estimated 2,000 new jobs would be created. The long-term benefits of the project, which would be realized after the implementation of an efficient comprehensive nutrition program, would be a generally improved health status and increased labor productivity by persons benefitting from the program.

Date approved: June 22, 1976 (IBRD)

POWER: This project is part of the program for the expansion of the power subtransmission and distribution systems during the years 1976 through 1979 of three public electric power utilities in Northeast Brazil: Companhia de Electricidade do Estado da Bahia (COELBA), Companhia de Electricidade de Pernambuco (CELPE) and Companhia de Electricidade do Ceara (COELCE); it also includes training, studies and technical assistance. Centrais Electricas Brasileiras S.A. (ELETROBRAS) will on-lend to the three utilities the Bank loan proceeds except for the amount allocated for training and consultants' services benefitting the sector as a whole.

Borrower: Federative Republic of Brazil, Centrais Electricas Brasileiras S.A. (ELETROBRAS).

Loan: $50 million; 20 years at 8.85 percent per annum. Total project cost: $145.4 million.

Purpose and Benefits: The project will help the three beneficiary state companies to meet the demands for electric energy resulting from the recent rapid growth of the industrial sector in the Northeast and the concomitant expansion of commercial and residential power demand, while also stimulating steps towards improving designs and reducing costs of rural installations to make them more affordable, rationalizing regulations for financing line extensions and revising the tariff structure with the purpose of better allocation of resources in the electric sector. The beneficiaries' 1976–1979 distribution investment program is based on the selection of the least-cost solution in all cases. In estimating the return on investment, the revenues from sales of electric energy to the ultimate consumer have been used as a proxy for the benefits attributed to the program. Bulk power costs have been evaluated at the long-term marginal cost of power generation and transmission in the Northeast region. Based on these assumptions, the return on the investment was calculated to be 16.5% for COELBA (43%

of the investment program), 18% for CELPE (35%) and 16% for COELCE (22%). The return on investment for the combined program is estimated to be 16.9%.

Date approved: June 24, 1976 (IBRD)

BURMA

AGRICULTURE: The project components are: (a) development of a veterinary and livestock extension service to cover about 375,000 bovines owned by 250,000 farm families; (b) production of vaccine against animal diseases; (c) improvement of 20,000 acres of communal pasture in about 300 villages; (d) construction of water points in about 50 villages; (e) development of ten livestock development centers (LDC) for the multiplication and supply to farmers of improved stock, pasture seeds, artificial insemination (AI) services and practical pasture and livestock production research studies; the importation of improved cattle, pigs and poultry, and cattle semen for the LDC and specialized dairy farms would be an integral part of project activities; (f) development of smallholder dairy production based on cross-breeding and improved nutrition together with the construction of two specialized dairy farms, as well as small dairy units on four selected LDC, improved milk marketing and processing would be provided by constructing and operating, near Rangoon, a milk processing plant, and associated milk collection centers whereas a feasibility study for a further milk plant near Mandalay would also be undertaken under the project; and (g) provision of technical assistance and training facilities for veterinary students.

Borrower: The Socialist Republic of the Union of Burma, Livestock Development and Marketing Corporation, the Department of Animal Husbandry and Veterinary Science and the Institute of Animal Husbandry and Veterinary Science of the Ministry of Education.

Loan: $7.5 million; 50 years at 0.75 percent. Total project cost: $12.8 million.

Purpose and Benefits: The primary benefit from the project will be an increase in the quality and number of draft animals for crop production and transport. Through crossbreeding and pasture improvement, milk and beef production, mainly by small farmers, would also be increased, milk production by about 11,000 tons and beef production by 5,000 tons per year (20,000 slaughter animals). The project would markedly improve the quality and value of livestock owned by about 250,000 small farm families, most with 5 ac or less. No problems in marketing the project output are expected. Assuming project benefits of $9.8 million per annum, average benefits per family are $60; this compares with average present income levels of about $240. The project would lead the way to further projects for improving livestock production. The estimated rate of return to the economy would be about 26 percent.

Date approved: December 23, 1975 (IDA)

AGRICULTURE: The project is designed to protect 185,000 acres of paddyland in the Lower Burma delta region from flood and tidal intrusions, strengthen extension and other agricultural supporting services, and investigate possible future measures for flood control and land reclamation as well as potential steps that could improve paddy storage and handling.

Borrower: Burma, Ministry of Agriculture and Forests (MAF).

Loan: $30.0 million; 50 years at 0.75 percent per annum. Total project cost: $54 million.

Purpose and Benefits: The primary benefit from the project would be the increase in crop production within the project area. Not only would crop damage be reduced because of greater protection from flooding and salt water intrusion but increased land-use intensity would become feasible with provision of lowlift pumps and reduced risks of crop loss. About 18,300 farm families would benefit directly from the project—12,800 existing farm families benefitting from protection against flood and salt water damage on presently cultivated land and 5,500 presently landless resident families receiving plot allotments from the 65,000 acres of reclaimed paddyland. The project would increase farm income two to three times from present average net income of about $34 and $46 per ac to $100 and $115 in the Lower and Middle Deltas respectively. The incremental rice and jute production would generate about $28 million per year in foreign exchange earnings. By way of comparison, annual incremental rice production derived from the project areas would represent approximately 51% of total 1975 rice export volume from Burma and about 48% of foreign exchange earnings from rice exportation in 1975. The economy is expected to realize an estimated 30% rate of return from total project investments.

Date approved: June 15, 1976 (IDA)

BURUNDI

AGRICULTURE: The project includes (a) inputs and strengthened extension services to sustain and extend the improvement of cultivation methods, started under the first coffee project; (b) inputs, field trials and extension advice for the cultivation of food crops; (c) a program of experimental activities in rural development; (d) construction of four additional coffee washing stations and technical assistance for the operation of the four existing stations and for trials with alternative processing methods; (e) staff and equipment for an expanded coffee research program; (f) construction and repair of potable water sources, bridges and culverts; and (g) a resident management team of international advisers to assist in project implementation.

Borrower: Republic of Burundi, The Office des Cultures Industrielles du Burundi (OCIBU) and the Institute des Science Agronomique du Burundi (ISABU).

Loan: $5.2 million; 50 years at 0.75 percent. Total project cost: $7.5 million.

Purpose and Benefits: About 110,000 farmers will be reached by the coffee component of the project. All will participate in the insect control program, and the majority will receive extension advice on improved cultivation practices. Increases in cash income would vary between $3 and $15 depending on the degree of participation. A much smaller number of farmers are expected to participate in the food crop program. Improved maize seed would increase the net value of the production of some 6,000 farmers by about $7, and some 2,000 of these farmers would further increase their incomes by about $20. Farmers in the high potential coffee areas who combine coffee improvement with the use of selected seed and fertilizers for maize would increase the net value of their production by about $32, an increase of about 35 percent of their total average production (about $332). While these benefits are low in absolute terms, they appear more reasonable in terms of present average cash income, which is estimated in the neighborhood of $70 equivalent. The economic rate of return for the project is estimated at 21 percent for the whole project, excluding the research program and technical advice. It is estimated at 17 percent without shadow-pricing.

Date approved: November 18, 1975 (IDA)

TECHNICAL ASSISTANCE: This project comprises: (a) about 10 man-years of long-term advisory services to strengthen planning, the statistical services and project preparation in the development ministries and the Bureau Technique d'Etudes (BTE), together with a limited amount of equipment and vehicles to support their work; and (b) about 150 man-months of short- and medium-term consultancies to (i) undertake preinvestment and feasibility studies and prepare projects for financing and (ii) conduct special studies related to project or economic policy implementation.

Borrower: Republic of Burundi.

Loan: $1.5 million; 50 years at 0.75 percent per annum. Total project cost: $1.8 million.

Purpose and Benefits: The technical expertise to be provided under this project would help the Government in its efforts to formulate an effective and well planned development program and to identify and prepare specific investment projects. It would help strengthen the Government's planning machinery by alleviating the critical shortage of experienced economists and statisticians. The project does, however, have risks. Difficulties may be experienced in recruiting suitably qualified experts and investment projects prepared by consultants may not always lead to viable projects. To minimize these risks, the Association would help recruit suitable advisers, and all contracts would be subject to the approval of the Association.

Date approved: February 17, 1976 (IDA)

AGRICULTURE: The project includes: (a) provision of fishing materials and equipment to fishermen; (b) development and expansion of fishing centers and stations; (c) improvement of fish marketing; (d) strengthening of fisheries extension services and training for fishermen; (e) construction and equipping of headquarters facilities for the Regional Development Society (RDS); (f) studies and pilot development activities for the Lake Tanganyika coastal region; (g) technical assistance, including training, studies and preparation of future projects.

Borrower: Burundi, The Regional Development Society (RDS), the National Bank for Economic Development (BNDE) and the Bureau of Technical Studies (BTE).

Loan: $6.0 million; 50 years at 0.75 percent per annum. Total project cost: $8.6 million.

Purpose and Benefits: At full development (in year six), the project should increase fish production by about 10,000 tons as compared to the present production of about 9,500 tons per year. The economic rate of return of the project is estimated to be 20 percent over 20 years. Benefits would flow to some 3,000 fishermen (including about 1,500 fishermen presently employed) who will earn between $300 and $600 a year of net cash income over and above fish retained for consumption, and to a broad range of the population who will be able to obtain an additional source of protein at a relatively low price. Additional jobs will be created for about 1,500 new artisanal fishermen, and for about 200 employees in the RDS fishing centers and stations and the five RDS fishing units. About 300 people will be employed in the construction of the project. The financial rate of return for the RDS on its commercial operations should be about 15 percent.

Date approved: April 20, 1976 (IDA)

CAMEROON

ENTERPRISE: The project consists of US $3.0 million to be lent to Government for relending to BCD (Banque Camerounaise de Developpement) to finance the establishment and expansion of an estimated 80 privately-owned small- and medium-scale manufacturing, artisan, service, transport, repair, and construction firms. The investment component is to be jointly financed with CCCE (Caisse Centrale de Cooperation Economique) and technical assistance will be mainly financed by UNDP (United Nations Development Program). The credit is expected 1) to bolster BCD's role as an effective development institution and improve technical assistance facilities for SME (small- and medium-scale enterprises) and 2) to provide a means for the Bank Group and Government to learn more about effective policies and procedures for SME promotion and financing and about the benefits accruing therefrom.

Borrower: United Republic of Cameroon, beneficiary is Banque Camerounaise de Developpement.

Loan: $3.0 million; 50 years at 0.75 percent per annum. Total project cost: $13.2 million.

Purpose and Benefits: The project would expand and improve the work of existing technical assistance agencies, increase their cost-effectiveness through a greater volume and concentration of operations, improve their coordination, and help them diversify regionally. The appraisal capacity of BCD will be strengthened and the impact of sub-projects improved through more systematic use of economic analysis. The proposed project would help promote new small entrepreneurs and a number of larger ventures, representing total investments of about US $11 million and resulting in employment involving upgraded skills for about 1,000 workers. It seeks to foster the development of a group of Cameroonian entrepreneurs, starting a cumulative process of the greatest importance for the private sector.

Date approved: July 1, 1975 (IDA)

EDUCATION: This project involves construction, equipment and furniture for (i) establishing two lower secondary technical schools in Douala and in Ngaoudere; (ii) expanding two existing lower secondary agricultural schools at Ebolowa and Maroua and establishing a lower secondary agricultural school at Bambili; (iii) expanding the regional upper secondary agricultural school at Bambili, and establishing two regional upper secondary agricultural schools at Eboiowa and Maroua (same sites in Bambili, Dbolowa and Maroua as in (ii) above; (iv) establishing a program for training higher technicians in agriculture and livestock at Yaounde; and (v) assisting the rural health training program of the University Center for Health Sciences (CUSS). Technical assistance will also be provided under the loan.

Borrower: United Republic of Cameroon, Ministry of Education (MOE); Ministry of Agriculture (MOA).

Loan: $17.0 million; 25 years, including seven years grace, at 4.5 percent per annum. Total project cost: $24.9 million.

Purpose and Benefits: To ensure that the formal technical training system is responsive to the actual needs of local industry and business, a Governing Board will be established for each of the two lower secondary technical schools in Douala and Ngaoundere. Through appropriately designed programs in new or expanded institutions and through improvement in student/teacher ratios, the project will also make agricultural and health education a more effective and cost efficient tool for agricultural and rural development. These programs would supply the qualified manpower that would introduce improved agricultural methods and would help to change attitudes towards agriculture. Specifically, the project would assist in: (a) improving the management of agricultural and rural education through measures to strengthen the MOA's current capacity in agricultural education planning, teaching methods and media resources for agricultural education and extension services, thus also laying the basis for a rural information system; (b) upgrading extension services by increasing the number of trained agents and improving the training of extension personnel at all levels; (c) supporting rural health training; (d) regionalizing agricultural training to cater for the varied agri-ecological regions in Cameroon; (e) filling a gap in the agricultural manpower structure by starting a new program for training higher technicians within the ENSA campus, but with budgetary and administrative autonomy.

Date approved: April 20, 1976 (IBRD)

TRANSPORTATION: This project includes: (a) a feasibility study to (i) determine, as part of a master plan, the capacity demand for railway terminal facilities in the Douala area by 1985; (ii) determine the optimum distribution among individual facilities; (iii) produce a preliminary design and cost estimates for the proposed facilities; and (iv) provide economic and financial justifications for these facilities. (b) Final engineering of the new Douala Railway Station and Marshalling Yard including geotechnical studies, the preparation of cost estimates and tender documents. (c) Other consulting services to (i) cover railway operations, commercial activities and management; (ii) study capacity restraints on Douala-Yaounde corridor.

Borrower: Regie Nationale des Chemins de Fer du Cameroon.

Loan: $2.3 million; 10 years at 8.5 percent per annum. Total project cost: $2.9 million.

Purpose and Benefits: The proposed new marshalling yard will have larger capacity than the existing one, and will also be located at a better site and closer to the Douala workshops. Three main sets of benefits are therefore expected to result from the project: (a) improved productivity of the wagon fleet; (b) reduced costs of movement of locomotives between yard and workshops, shorter mainline hauls, and elimination of delays and damage caused by periodic flooding of the existing yard; and (c) avoidance of diversion to road transport of additional traffic which the existing marshalling yard could not handle; road transport is generally more expensive than rail due to climatic and road conditions, therefore, the diversion costs would be significant. Additionally, benefits will probably be obtained from reduced pilferage and from an improvement in urban traffic flows; however, there is not enough data to quantify these benefits. The best present estimate of the economic return on the construction project is 29 percent.

Date approved: May 4, 1976 (IBRD)

CARIBBEAN DEVELOPMENT BANK

INTERMEDIATE CREDIT INSTITUTIONS: The proceeds of these loans will be relent by the Caribbean Development Bank (CDB) to member countries for agriculture, agro-industry, manufacturing industry, tourism, transportation, public utilities, sites and services, and technical and vocational education and training. Relending of Bank funds in other sectors can also be undertaken with Bank approval, provided they are sectors included in the Bank's own lending activities and that CDB has developed the necessary technical capacity.

Borrower: Caribbean Development Bank.

Loan: $20 million (in two loans of $3 million at 4½ percent for 25 years and $17 million at 8½ percent for 25 years).

Purpose and Benefits: The major and perhaps most critical development problem confronting the countries of the Caribbean is the persistent and high level of unemployment which pervades the region. It is estimated that about 13 percent of the region's labor force is openly unemployed and another 4 percent have withdrawn from the labor market because of the lack of employment opportunities. The unemployment problem needs to be tackled in the context of inducing a higher rate of economic growth and in this respect an improved export performance is of prime importance. This will require a stricter control over costs and greater productivity in export industries to ensure that a competitive edge is maintained in overseas markets. For the longer term it will be important to develop the skills of the labor force through a more intensive program of industrial and technical training. In order to achieve the rates of growth necessary to make any significant impact on unemployment, a major effort is needed to revitalize the agricultural sector in the region. Underlying its stagnation are basic problems such as a skewed land distribution, poor agronomic practices, rising unit production costs and a widening gap between earnings in agriculture and other economic activities. Stronger and more determined efforts need to be made to rehabilitate the export sub-sector, improve efficiency and contain costs, and utilize land more productively. The CDB, as an important regional development institution, can play a unique role in mobilizing financial assistance, particularly to this sector. Thus, it is advantageous for the IBRD to utilize the CDB as a channel for its resources because of its intimate knowledge of the area.

Date approved: March 30, 1976 (IBRD)

CHAD

AGRICULTURE: The project consists of: (a) rehabilitation and completing the irrigation and drainage networks of Guini polder (370 ha net area): (b) constructing the irrigation and drainage networks for Berim polder (800 ha net area); (c) establishing a Commercial Agricultural Development Section to prepare for farmer settlement, and be responsible for the first year of operation on all newly developed land; (d) providing a package of services (resettlement assistance, training extension, credit and marketing) to the new farmers; (e) constructing necessary service centers and houses for project staff; (f) expanding adaptive agricultural research at the Matafo Research Station; and (g) providing consultant services to reorganize the Societe de Developpement du Lac Tchad (SODELAC).

Borrower: Republic of Chad, Societe de Developpement du Lac Tchad (SODELAC).

Loan: $5 million; 50 years at 0.75 percent. Total project cost: $13 million.

Purpose and Benefits: The proposed project holds the promise of drought protection and high yields of food crops and cotton. In view of the fragility of the present

CHAD—Continued

rain-fed farming system, investment in irrigation—despite its high cost—is essential in Sahelian countries such as Chad, if any type of sound economic base is to be established and sufficient food production assured. The project's direct benefits would be the 3,000 tons of wheat and the 3,000 tons of seed cotton production that it would generate annually, and which would cause the per capita income of the 1,200 farm families involved to increase from US $35 to about US $300. Pricing the work of the farmers at the minimum wage rate for the agricultural sector results in a rate of return of 13 percent. The project would also have a number of secondary benefits including the prevention of progressive salanization, creation of a pole of development in an exceptionally fertile area and help stabilize the farm community by reducing the income disparity between northern and southern regions.

Date approved: November 11, 1975 (IDA)

CHILE

INDUSTRY: This project's purpose is (i) to maintain, render more effective and, in a few cases, to slightly expand Chile's capacity to process copper ore and copper by-products; and (ii) to strengthen the Coporacion del Cobre (CODELCO) and Empresa Nacional de Mineria (ENAMI) management while also improving planning and policy making within the sector. Individual subprojects to be financed under the loan include:

I. *For CODELCO:* (a) an underground crushing plant, and related infrastructure, at the El Teniente Mine; (b) rehabilitation of the Barquito power plant which supplies the El Salvador Mine and smelter facilities; (c) a selenium recovery plant at Chuquicamata to process anode slimes from the Chuquicamata and El Salvador Mines; and (d) technical assistance. II. *For ENAMI:* (a) the replacement of antiquated or obsolete equipment at the Paipote and Ventanas smelters and the modification of both smelters' burners to enable them to operate on Chilean coal as well as petroleum products; and (b) technical assistance.

Borrower: Republic of Chile, Coporacion del Cobre (CODELCO) and Empresa Nacional de Mineria (ENAMI).

Loan: $33 million; 15 years at 8.5 percent per annum. Total project cost: $76.8 million.

Purpose and Benefits: The financial rates of return for the individual subprojects are expected to range from 35 to over 50 percent. The economic rates of return will be marginally higher than the financial ones since transfer payments to the Government, apart from taxes, are not significant and more than 95 percent of the copper will be exported at world market prices. Foreign exchange earnings stemming from project investments—due either to averted production losses, as in the case of the critical rehabilitation components, or to increases in the output of processed copper or copper byproducts—are expected to rise to over $100 million per annum by 1980. The project will also yield other major benefits for the sector including greater efficiency and lower operating costs, improved planning, project preparation and implementation, and an enhanced absorptive capacity for future investments. Combined, the benefits accruing from this project will help Chile to maintain its strong competitive position amongst the world's copper producers.

Date approved: February 3, 1976 (IBRD)

COLOMBIA

INTERMEDIATE CREDIT INSTITUTION: This sixth project comprises (a) financing the foreign exchange component of the investment projects of private sector productive enterprises, principally manufacturing firms (US$70 million of the Bank loan); (b) financing the upgrading or adaption of technology by private firms (US$5 million of the Bank loan); and (c) financing equity investments by the *financieras* (DFCs) in new enterprises to be established outside Colombia's present major industrial centers (US$5 million of the Bank loan). Peso-denominated financing of investment projects would be available only for (a) the projects of firms with total assets under $3 million; (b) export projects; and (c) projects to be located outside the present major industrial centers.

Borrower: Banco de la Republica (BR).

Loan: $80 million; 17 years at 8.5 percent per annum.

Purpose and Benefits: The *financieras* have become the most important source of term finance for industry in Colombia. The oldest and largest of them now provide about 12 percent of the financing for industrial investment, besides offering seed capital for new ventures and fostering more efficient resource allocation through their role in project preparation and evaluation. A study sponsored by the Bank in 1974 demonstrated that on the average the projects funded by the *financieras* had favorable economic (average 32 percent) and financial (average 18 percent) rates of return and were relatively labor intensive. Another interesting finding of this study was that the Government, through the tax mechanism, received by far the largest share of the net economic benefits of *financiera* projects.

Date approved: March 16, 1976 (IBRD)

CONGO

TRANSPORTATION: The main components of the project to be financed with this loan are as follows: (a) Agence Transcongolaise de Communications (ATC) Headquarters: provision of technical assistance and improvement of training facilities and program; (b) Pointe Noire Port: provision of additional stacking areas for timber-handling, construction of new manganese and general cargo berths, and dredging; (c) River Services: procurement of mechanical handling equipment and additional floating craft, expansion of Brazzaville workshops, and deepening of river channels; (d) CFCO railway: procurement and renewal of locomotives and rolling stock, track renewal, installation of signaling passenger or freight cars systems, and expansion of workshops; and upgrading of 18 km and realignment of 88 km of the Holle-Loubomo section.

Borrower: People's Republic of the Congo, Agence Transcongolaise de Communications (ATC).

Loan: $38 million; 25 years, including five years of grace, with interest at 8.5 percent per annum. Total project cost: $233.8 million.

Purpose and Benefits: In order to maintain and strengthen the role of Congo as a major transit country, and in order to permit at the same time larger timber exports from Congo, this project, together with ATC's long-range investment program, has been designed to improve operations and lay the groundwork for capacity expansion. ATC's future transport role is thus expected to remain that of a regional carrier for the Congo, CAR, southeastern Cameroon, southern Gabon, and to a lesser extent, southern Chad. The most important element in the regional traffic flow, in terms of value and economic impact, will be timber originating in northern Congo, southeastern Cameroon and southwestern CAR. Although it is assumed that the present world market slump in timber will continue through 1976 before recovering in 1977, Pointe Noire port is expected to handle about 1.0 million tons in 1978 and 2.0 million tons in 1985, mainly as a result of opening up the forest reserves in northern Congo. Gabonese manganese will continue to provide substantial traffic volumes, at least into the early 1980's. Traffic in manganese ore is expected to increase to 2.6 million tons in 1981. The remaining important traffic flows will consist of general cargo, bulk oil, and CFCO passenger traffic.

Date approved: March 23, 1976 (IBRD)

COSTA RICA

TRANSPORTATION: This project consists of: (a) construction, including consulting services for supervision of civil works, of two new main highways, San Jose-Rio Sucio-Siquirres (about 96 km) and Rio Sucio-Puerto Viejo (about 29 km); (b) establishment of two permanent weighing stations and the purchase of portable scales, and of vehicles and equipment for construction supervision; (c) technical assistance for: (i) transport planning; and (ii) preparation of an urban transport project for San Jose.

Borrower: Republic of Costa Rica.

Loan: \$39.0 million; 25 years at 8.5 percent per annum. Total project cost: \$74.0 million.

Purpose and Benefits: The proposed 96-km San Jose-Rio Sucio-Siquirres highway, together with the 29-km Rio Sucio-Puerto Viejo connection would be parts of the basic trunk road system in Costa Rica, completing the first all-weather road link from the capital to the Caribbean. Major benefits from this project will result primarily from (a) reduction of operating costs, generation of time savings to road users and provision of all-weather service to areas previously completely isolated (or isolated during the 6-month rainy period), thus helping to bring these areas into the mainstream of the country's economic life; (b) facilitation of access to new agricultural and forested areas, thus stimulating the full development of their productive capacity.

Date approved: December 30, 1975 (IBRD)

CYPRUS

INTERMEDIATE CREDIT INSTITUTIONS: The objective of this project is to further strengthen the Cyprus Development Bank's (CDB) limited capacity and ability to stimulate viable investments in the manufacturing, tourist and services sectors, as well as small-scale industries, and to assist CDB in financing the foreign exchange cost of its sub-projects in those sectors. The loan will provide about 40 percent of the projected financial resources, and 60 percent of foreign exchange, needed by CDB over approximately the next 30 months.

Borrower: The Cyprus Development Bank Limited (CDB).

Loan: \$6 million, repayable substantially in conformity with the aggregate of the amortization schedules for subloans and investments for which withdrawals from the loan account are approved or requested at 8.5 percent per annum.

Purpose and Benefits: Normal DFC business prospects for CDB are good, and arise from the Government's proposed investment objectives and program in the manufacturing and tourist sectors which are intended to accelerate economic growth in southern Cyprus. A relatively stable situation has been reestablished and this has enabled the business community in the southern part of the island to regain confidence in its economic prospects. Steps taken by the Government to stimulate industrial and tourist investments include the development/expansion of industrial estates in Nicosia, Larnaca, Limossol and Paphos, creation of a free trade zone in Larnaca, and the provision of low interest loans. Projections relating to the industrial, tourist, and other sectors provided to the Bank, seem to represent a realistic target. Based on the data provided, the current pipeline for 1976–77 and thereafter, show an annual growth rate of 15 percent for industrial projects, 40 percent for tourism, and 10 percent for others.

Date approved: May 28, 1976 (IBRD)

EAST AFRICA

INTERMEDIATE FINANCIAL INSTITUTION: The loan funds will help to meet part of The East African Development Bank (EADB's) financial requirements for the financing of the import components of industrial projects through 1977.

Borrower: The East African Development Bank (EADB).

Loan: \$15.0 million, repayable substantially in conformity with the aggregate of the amortization schedules for subloans at 8.5 percent per annum.

Purpose and Benefits: Since its establishment, EADB has approved \$40.7 million in loans; 75 percent of EADB's 52 loans have been to manufacturing projects and 21 percent to processing projects. This relending has encompassed a wide variety of industrial subsectors; textiles, iron and steel, wood industries, plastics and rubber, cement, salt and sugar. EADB has played a significant role in trying to achieve the complementary development of the Partner States, EADB has been able to provide valuable intelligence on Community industrial sector developments and influence the design and size of many projects in order to prevent duplication of productive capacity. Furthermore, EADB has cooperated extensively with the other development banks in East Africa. In the many jointly financed projects undertaken, the experience and expertise of EADB's appraisal staff has been of assistance to the newer national institutions. Because of EADB's multinational ownership, the findings of the analyses and studies undertaken by EADB has been considered independent of national bias by member governments. EADB has the staff and resources to independently undertake studies on behalf of Government or private clients.

Date approved: February 3, 1976 (IBRD)

ECUADOR

AGRICULTURE: The project includes: (a) establishment and training of a planning and project preparation group within the Planning Board (JUNAPLA); (b) preparation of one or two rural and agricultural development projects in the Lower Guayas Basin, and carrying out studies contributing to a long-range water-control and agricultural development plan for that Basin; (c) preparation of two rural development projects in the mountainous highlands of the Andes in the province of Tungurahua; and (d) preinvestment studies of rural development possibilities in the Esmeraldas river basin.

Borrower: Ecuador, Preinvestment Fund (FONAPRE), National Planning Board (JUNAPLA).

ECUADOR—Continued

Loan: $4 million; 15 years at 8.5 percent. Total project cost is $5.6 million.

Purpose and Benefits: The technical services to be provided under the project will help strengthen the capabilities of Ecuadorian agencies in rural development and reduce the critical shortage of skilled manpower. The project will assist the Government to increase the number of well-prepared priority projects and to shift some of the emphasis of its investment programs from infrastructure to rural development. Moreover, without this proposed assistance, future rural development project preparation would very likely result in more costly and/or ineffective projects, consequently frustrating the Government's goals of improving the quality of life of the rural poor and raising agricultural production. Thus, there would be achieved better resources allocation, as well as a basis for improved use and coordination of external financial assistance. However, since the investment costs of most of the projects which will be prepared and implemented as a result of the subprojects financed by the loan are not yet determinable, it is not possible to quantify their likely benefits in a meaningful fashion. The execution of the project does not entail substantial risks but does place considerable responsibility on the quality of the staff that JUNAPLA assigns to the rural development planning unit and the specialists to be recruited as their advisors. Both would require close monitoring by the Government and the Bank. In order to minimize the risks, the aforementioned specialists would be appointed with the approval of the Bank. The terms of reference of all studies financed under the loan would be approved by the Bank.

Date approved: March 30, 1976 (IBRD)

AGRICULTURE: This project includes: (a) the installation of three seed processing plants, including storage facilities, for up to a total of 13,000 tons of seeds. These plants would be equipped for weighing, receiving, drying, conditioning, cleaning, grading, treating, bagging, labeling, quality control testing, and storing seeds; (b) the expansion of storage facilities at the four research stations responsible for providing breeder seeds and for producing basic and registered seed, to handle an additional 500 tons; (c) the construction and/or improvement of seed warehouses; (d) the provision of additional personnel, equipment and training; (e) the establishment of a National Seeds Council (NSC) for national policy regulation and coordination; and (f) the training of personnel in different aspects of the industry, plus related technical assistance.

Borrower: Ecuador, Empresa Mixta de Semillas (EMS).

Loan: $3 million; 15 years at 8.5 percent per annum. Total project cost: $5 million.

Purpose and Benefits: The benefits of the project consist of the incremental yields derived from the use of certified, rather than ordinary seeds. These certified seeds have to be produced domestically, so as to be adapted to Ecuador's diverse micro-climates. The yield increases expected as a result of the project are 12 percent for soybeans, 20 percent for barley, corn and wheat, and 25 percent for rice. These estimates assume no increase in the use of fertilizers and other complementary inputs, and no other improvements in farming practices. The larger scale, more progressive farmers are likely to profit first from the provisions of certified seed. However, the seeds to be produced include those for the crops usually planted by small farmers who would also be assured of an improved availability of credit for seed purchases. Substantial numbers of small farmers therefore would benefit as well. The project would increase the availabilities of certified seeds, up to twice the current level, or 30 percent of total requirements.

Based upon the expected yield increases, the project's economic rate of return has been estimated at 48 percent. Even if yields were to increase by only half of the expected proportions, the rate of return would still be 16 percent. Moreover, the additional agricultural production made possible by this project would reduce the country's food import bill by more than $4 million in 1980. The execution of the project does not entail substantial ecological risk. Some of the institutional aspects—particularly the coordination of all project activities and of related extension and credit facilities in the framework of the National Seeds Council—are fairly complex and would require a close monitoring by the Government and by Bank supervision missions to ensure the timely achieving of the project objectives in this respect.

Date approved: March 30, 1976 (IBRD)

TRANSPORTATION: This project involves improvement of about 49 kilometers of road. In addition, a road maintenance program in one of the four maintenance districts of the Ministry of Public Works (MOP) to improve work methods and administrative procedures ultimately extending to all maintenance districts will be set up as will programs to improve planning and coordination in Ecuador's transport sector, the planning and engineering capabilities of MOP's Directorate of Highways, and to improve the capability of the Ecuadorean roads construction industry. Rural development studies will be undertaken for the areas affected by the project.

Borrower: Ecuador, Ministry of Public Works (MOP).

Loan: $10.5 million; 25 years at 8.5 percent per annum. Total project cost: $21 million.

Purpose and Benefits: The investment in the improvement of the Babahoya-Balzapamba road, which accounts for 65 percent of the estimated project cost, would have an economic rate of return estimated at 14 percent. Approximately 40 percent of the area affected by this project is still covered by forests amenable to exploitation. The climatic and soil conditions of this area also permit cultivation of bananas, cacao, coffee and rice and, in the higher ground around Balzapamba, citrus fruits. This would be of particular significance for the Babahoyo-Montalvo irrigation project, now being implemented by a regional government agency, which envisages new plantations of rice, soybeans, maize, sesame and beans on about 10,000 ha. The improved road would permit faster access for the expected increased volumes of these crops to the Guayaquil metropolitan market and to the export markets through the Port of Guayaquil.

Date approved: March 30, 1976 (IBRD)

TRANSPORTATION: These loan funds will help to finance: (a) the construction of (i) three alongside deepwater berths for containers and general cargo traffic, four transit sheds, open storage areas, and associated facilities; and (ii) a bulk cargo terminal comprising one alongside deep-water berth and mechanized storage and loading facilities for sugar, wheat, molasses and edible oils; (b) the relocation of the existing small boat moorings; (c) the acquisition of cargo handling and workshop equipment; and (d) the provision of technical assistance to (i) improve port operations, (ii) carry out a training program for shore labor, stevedores, and equipment operators; and (iii) manage the proposed bulk terminal for two years and train Guayaquil Port Authority staff to operate and maintain it thereafter.

Borrower: The Guayaquil Port Authority (GPA).

Loan: $33.5 million; 24 years at 8.5 percent per annum. Total project cost: $83.6 million.

Purpose and Benefits: Although Guayaquil's share of total traffic is expected to decline somewhat as other seaports are expanded, Guayaquil is expected to remain the leading port in Ecuador. Import traffic at Guayaquil is expected to grow at 7.5 percent per annum while exports would increase at 2.5 percent per annum during the period 1975–85. Consequently, overall traffic tonnage is expected to grow from 1.8 million tons in 1974 to 3.27 million tons in 1985. Therefore, if the Port of Guayaquil were not expanded now, it would become a serious bottleneck for the flow of imports and exports in Ecuador. This accounts for the high priority assigned by GPA and the Government to this project whose principal benefits consist of savings in ship turn-around time, cargo handling and traffic diversion. The project would have an overall economic rate of return of 14 percent.

Date approved: May 11, 1976 (IBRD)

EGYPT

DEVELOPMENT FINANCE COMPANY: This second loan will finance part of the Bank of Alexandria's (BOA) foreign exchange requirements for its development finance operations through mid-1977. The proceeds of the credit would be made available for onlending to both private and public sector enterprises to finance replacement and new capacity capital expenditures. Experience with the first credit has shown that there is a strong demand for public sector enterprises for foreign exchange, and it is proposed that BOA retain some ability under this credit to respond to that demand. Nevertheless, the Government has expressed a policy of increasing the support for private sector activities; consequently, a minimum of 65 percent of the credit is to be used for private sector financing, compared with a minimum of 50 percent under the first credit. BOA expects the proceeds of the credit for the private sector to be spread over a relatively large number of medium- and small-sized projects covering a number of industries.

Borrower: Egypt, Bank of Alexandria (BOA).

Loan: $25 million; 50 years at 0.75 percent per annum.

Purpose and Benefits: BOA is the Government's designated source of term lending to the private industrial sector and the IDA funds constitute the sole foreign exchange available to the sector from institutional sources for private industrial investment purposes. Therefore, the credit makes a major contribution to implementation of the Government's policy of expansion and diversification of private industry which, in turn, supports its liberalization policy. BOA is an important institution which has demonstrated its ability to use capital effectively.

Date approved: July 15, 1975 (IDA)

TRANSPORTATION: The main elements of this project are: (i) the dredging of 1.8 million m³ accumulated sand in the existing entrance channels and harbor. This is maintenance dredging which has been deferred due to the lack of dredgers; (ii) completion of the opening of a new channel by dredging 800,000 m³ to provide additional access, which will make ship traffic flows easier and safer to accommodate and control; (iii) paving and surfacing roads and work areas; (iv) establishing a new general cargo storage area outside the port; (v) building 550 m (3 berths) of deep sea quay; (vi) procuring floating, cargo handling, communication and transport equipment for port operations; (vii) procuring maintenance equipment; (viii) consultancy studies for management, organization, accounting and training; and (ix) consultancy services for final project design and engineering, including soil investigation, and preparation of tender documents.

Borrower: Alexandria Port Authority (APA).

Loan: $45.0 million; 25 years at 8.5 percent per annum. Total project cost: $151 million.

Purpose and Benefits: Total dry cargo traffic handled through Alexandria Port rose from 8.1 million tons in 1973 to 9.3 million tons in 1974 and is expected to be about 10.7 million in 1975 and 14.0 million tons in 1980. This large increase reflects the recovery of the Egyptian economy as well as the major role played by the Port of Alexandria, which handles presently 90 percent of the traffic through all Egyptian ports, and is expected to retain a very major share of traffic (at least 80 percent in 1980) after the other ports are reopened or improved. The project is expected to improve overall productivity for general cargo traffic. Traffic will benefit from more and better handling gear, more storage space, quicker clearance of the discharged cargo from sheds, unitized handling, the entry of larger ships due to dredging, and the use of a larger number of hooks per ship resulting from the availability of more shore cranes.

Benefits have been quantified as savings from reduced shipping costs, arising from the scale-economies in using bigger ships after dredging, and from reduced ship service-time and ship-waiting time due to increased productivity and additional berth capacity. Overall, it is estimated that about 85 percent of the ship cost savings arising from the project would be transferred to Egypt. However, for assessing the economic return from the project, only 50 percent of the total ship cost savings has been taken into account. It is estimated that the project will yield an economic return of above 50 percent, and a first year return, using a 12 percent discount rate, of 37 percent.

Date approved: April 6, 1976 (IBRD)

AGRICULTURE: This project is designed to increase the productivity of the Borrower's horticultural sector, to satisfy growing domestic demand, and to generate foreign exchange earnings through import substitution of vegetable seeds and exports of fruit and vegetables.

Borrower: Egypt, Bank Misr.

Loan: $50.0 million; 25 years at 4.5 percent per annum. Total project cost: $108.1 million.

Purpose and Benefits: The economic rate of return of this project is estimated to be 38 percent for the seed production component, the cost of which is $31.3 million, 19 percent for the Nubariya Outfall costing $41.7 million, and 35 percent for the horticultural and agro-industries components, costing $35.0 million. The overall economic rate of return is estimated at about 33 percent. The project is expected to generate a total of about 10,000 to 15,000 new jobs at full development. Approximately 5,000 jobs will be created on the seed farm. In addition, small increases in employment are likely to be generated by the other horticultural sub-projects, while the Nubariya drain, by increasing fertility of the reclaimed lands, will permit further agricultural development and thus increase employment.

Date approved: May 28, 1976 (IBRD)

EGYPT—Continued

AGRICULTURE: This project includes: (a) installation of about 50,000 km of buried field drains of PVC corrugated pipes and 6,000 km of buried field collectors of cement pipes in the selected areas totaling 500,000 feddans; (b) deepening and widening of about 1,226 km of existing, and excavation of about 346 km of new open drains, involving approximately 23 million m^3 of excavation; (c) construction of one pumping station of a capacity of 3.5 m^3/sec, including transmission line; and (d) reclamation by leaching of about 12,000 feddans of saline soils distributed throughout the area to be drained including subsoiling and gypsum application in about two thirds of this area where soils are alkaline. 2. (a) Extension of the Government's bilharzia control program by about 120,000 fd abutting the existing program area and between the Asyut and Dairut barrages. (b) Financing the cost overrun on molluscicide procurement under the first Upper Egypt Drainage project.

Borrower: Egypt, Egyptian Public Authority for Drainage Projects (EPAD)

Loan: Credit $40 million; Loan $10 million; 50 years at 0.75 percent and 25 years at 8.85 percent per annum, respectively. Total project cost: $282 million.

Purpose and Benefits: The project is designed to help arrest the steady and persistent decline in yields, estimated to reach at least 30 percent over the next 35 years, due to water-logging and salinity. It would also bring about a substantial increase in agricultural production on the 500,000 fd that would be drained. At full development, yield increases due to the project are expected to stabilize at 15 to 35 percent above present levels. The additional production would enable some increased exports in the case of cotton, onions (which are currently affected by a disease due to water-logging) and vegetables or reduced imports in the case of other products absorbed by the local market. The drainage component will benefit about 147,000 farm families or about 882,000 persons, occupying small farms, about half of whom have annual incomes below the relative poverty level. Without the project, significant declines in farm incomes over present levels would be experienced. Further benefits would accrue to farmers whose presently barren land would be restored to production. The economic rate of return from the drainage component which accounts for $276.7 million or 98 percent of the total project costs, based on the above benefits and a 35-year project life, is estimated to be 29 percent.

Date approved: June 8, 1976 (IBRD)

INDUSTRY: The project consists of: (1) the Misr Fine Spinning and Weaving Company Kafr El Dawar (KED) subproject, to add about 78,000 spindles and 900 looms which would help to increase the company's manufacturing capacity of fine cotton and polyester cotton fabrics by 16.5 and 10.1 million linear meters respectively; (2) the Misr El Beida Dyers (EB) subproject, to expand the company's converting capacity by 43 million meters of fabric and 1,550 tons of yarn and, in addition, replace obsolete equipment for converting 30 million meters of fabric and 500 tons of yarn. The EB subproject also includes expansion of the caustic soda recovery and fabric coating operations; (3) provision of technical assistance and training to KED's and EB's personnel; (4) provision of training abroad of technicians and supervisors from the Egyptian textile sector; (5) provision of technical assistance for the preparation of a follow-up textile project; and (6) establishment of policies, an action program and institutional measures designed to revitalize textile exports to convertible currency areas.

Borrower: Arab Republic of Egypt; Misr Fine Spinning and Weaving Company Kafr El Dawar (KED) and Misr El Beida Dyers (EB).

Loan: $52.0 million; 15 years at 8.85 percent per annum. Total project cost: $153.2 million.

Purpose and Benefits: The project aims to expand and rehabilitate the cotton textile production capacity of two state-owned textile mills. The economic rate of return for the KED component of the project is estimated to be 21 percent, for the EB component 22 percent; and the overall economic rate of return of the project is estimated at 22 percent. This aggregate rate of return excludes the costs for sectoral training and technical assistance since the benefits deriving from this investment cannot be easily quantified. The export promotion assistance would be particularly beneficial in stabilizing and improving Egypt's foreign exchange earnings. The project will provide new employment to about 2,850 people which represents an increase of about 10 percent of the present employment of the two companies. The foreign exchange savings from the project would be of importance to the Egyptian economy, since, by 1980, the net annual foreign exchange savings would amount to about $52 million.

Date approved: June 22, 1976 (IBRD)

EL SALVADOR

POWER: The project consists of: (a) supply and installation of the third unit (about 30 MW) at the Ahuachapan geothermal plant; (b) construction of about 39 circuit-km of new 115 kV transmission lines; (c) conversion of about 83 circuit-km of existing 69 kV transmission lines to 115 kV; (d) construction of about 20 circuit-km of 46 kV sub-transmission lines; (e) construction and/or improvement of 10 substations, including the addition of about 150 MVA to the system; (f) improvements and additions to CEL's communication and control system; (g) studies of other geothermal fields; and (h) about 500 man-months of consultants' services for: (i) tariff studies (10 man-months), (ii) geothermal studies (100 man-months) and (iii) detailed engineering and supervision of construction (390 man-months).

Borrower: El Salvador, Comision Ejecutiva Del Rio Lempa (CEL).

Loan: $39 million, $9 million for 25 years at 4.35 percent (TW) and $30 million for 25 years at 8.85 percent per annum. Total project cost: $50.2 million.

Purpose and Benefits: The project would enable El Salvador to use its geothermal potential to meet growth in demand and thus reduce its dependence on imported fuel. The geothermal unit represents the least-cost solution to meet power needs after 1981 for all discount rates below 23 percent. The proposed program, which schedules operation of the Third Unit by mid-1980, is the least-cost solution for all discount rates below 13.6 percent when compared to an alternative program which defers the in-service date to the end of 1981. The rate of return on project investment is estimated to be at least 14 percent, using as the measure of benefits tariff revenues and also fuel savings to the extent that the Third Unit will temporarily replace existing fuel-fired capacity.

Date approved: June 17, 1976 (IBRD)

ETHIOPIA

AGRICULTURE: The project would, over a five year period, provide for the development and rehabilitation of three lowland range areas inhabited mostly by nomadic pastoralists engaged in traditional extensive livestock grazing and production. Specifically, the project would provide for: (a) the institution of land planning and range management programs in conjunction with a program for the gradual control of livestock numbers; (b) the establishment of a basic veterinary and livestock extension service designed to reach the nomadic pastoralists; (c) construction of water facilities including both permanent and rainy season water ponds as well as a small number of boreholes and concrete water tanks; a limited water spreading program would be carried out in the Northeast Rangelands area; (d) construction of trade roads and feeder tracks; (e) the development of fattening ranches and a feedlot (Southern Rangelands only) and smallholder fattening schemes; (f) a program of trials and studies with emphasis on improved range use and grazing control practices; (g) training of project staff, livestock owners and tribal leaders; and (h) provision of supplemental staff within the Livestock and Meat Board (LMB) in order to improve its overall efficiency and to enable it to provide technical and administrative services as well as staff for the three sub-project units.

Borrower: Ethiopia, Livestock and Meat Board (LMB).

Loan: $27.0 million; 50 years at 0.75 percent. Total project cost: $42.9 million.

Purpose and Benefits: Through the restructuring of the traditional system of extensive livestock production, the project would increase the presently low marketed offtake from the ranges and would raise the value of marketed livestock production; this would result in increased cash incomes for the producers, thereby integrating them more fully into the market economy. Finally, the improved animal husbandry practices and fattening components would increase exports of live animals and would provide an even flow of quality meat both for export and for sale on local markets. The overall economic rate of return for the project over 20 years is estimated at 24 percent. The project would also have a number of additional benefits which are more difficult to quantify. These would include: (a) better nutrition for about 100,000 pastoral families through increased milk production; (b) more sanitary and more accessible water supplies for about the same number of pastoral families; (c) greater safeguards against future droughts, thus reducing the extent of both human and livestock deaths as well as the required level of Government expenditures for future relief programs; and (d) rationalization and modernization of the traditional livestock sector to safeguard the potential for livestock production of Ethiopia's rangelands.

Date approved: December 23, 1975 (IDA)

FIJI

TELECOMMUNICATIONS: The main features of the project are: (i) the expansion of capacity of the local telephone service by the installation of automatic switching equipment to provide 5,400 additional subscribers' lines together with cable network and associated facilities; (ii) the extension of the long distance service by installing radio systems and carrier equipment to improve interconnections between the main population centers and to provide services to remote islands and rural areas not being served presently; (iii) the expansion of telex exchanges by installing about 90 teleprinters, and of international services; (iv) construction of buildings and provision of miscellaneous facilities; and (v) consultants' services for procurement.

Borrower: Fiji, Department of Posts and Telecommunications (P&T).

Loan: U.S. $5 million; 20 years at 8.5 percent per annum. Total project cost: $14.0 million.

Purpose and Benefits: The Government has assigned the highest priority to the project because it would help support Fiji's development objectives by providing and improving essential services to tourism, industry, trade, agriculture and business activities. The importance of good telecommunication services arises from Fiji's geography and topography. There are few roads; and public transportation facilities are inadequate. The difficult and time-consuming transportation of people across hilly terrain and over wide expanses of ocean makes reliable telecommunication services indispensable to production and marketing of goods for domestic consumption and for exports, for coordinating transportation, for maintaining social and administrative contact between population centers and remote rural areas, and for developing tourism, trade and commerce. The project will extend telecommunications services to remote islands and to isolated rural areas on the two main islands, assisting in the production, distribution and marketing of agricultural products. New telephone connections are authorized on the basis of a priority list under which commercial and business subscribers' demands are given high priority, followed by those of medical, security and other essential services, and lastly by those of residential subscribers. Posts and Telecommunications (P&T) will establish services to about 18 remote and isolated areas of Fiji. In addition P&T will extend the telephone services to some 15 villages on Viti Levu by providing coinboxes and public telephones. The internal financial return on the project is about 15 percent. A sensitivity analysis allowing for a 10 percent increase in capital and operating cost and a 10 percent decrease in revenues would result in a rate of return of 11.5 percent. The economic rate of return is probably high because, first the price charged for the service may not adequately represent the full benefits to the subscribers, particularly those obtaining new services; second, there would be external benefits which accrue to parties other than those who pay directly for use of facilities; third, although the cost of extending services to new areas is taken into account, the full benefits would accrue only in the future when additional lines are connected in those areas.

Date approved: July 8, 1975 (IBRD)

AGRICULTURE: This project consists of clearing about 8,000 acres of land for planting sugarcane, providing housing material, land preparation, inputs up to the first harvest and first year subsistence loans for about 400 new settlers, building a sugar tramline extension of about 6.5 miles from Wailevu to Tambia, building and upgrading about 17 miles of main road from Tambia to Vunimako and construction of 117 miles of farm access roads, providing sites and services for a new township at Seaqaqa, and constructing a road maintenance sub-depot at the Seaqaqa township. The project also involves loans from FDB to individual settlers and NLDC for tractors, farm implements and sugarcane transport vehicles, procurement of road construction and maintenance equipment, drainage improvements and the purchase of vehicles and construction of offices.

Borrower: Fiji, Public Works Dept., Ministry of Agriculture, Fisheries and Forest.

FIJI—Continued

Loan: $12 million; 20 years at 8.5 percent per annum. Total project cost: $26 million.

Purpose and Benefits: At full development, annual incremental sugarcane production from this project is expected to be 330,000 tons. Resulting raw sugar exports of 41,000 tons would earn about $13 million a year in foreign exchange. The project would benefit some 3,400 sugarcane farmers and their families, or 17,000 people, plus 500 new township residents. It would also create 3,500 agricultural jobs during the six-month crushing season and 700 jobs during the slack season. Annual per capita incomes in the settlement area would increase from about $200 at present to $800 after repayment of project loans, which would be approximately equivalent to the national GDP per capita which is expected to be about $870 at that time (1985). Per capita incomes of farmers affected by poor drainage would increase from their present level of around $550 to about $870 as a result of the improvement under the project.

Date approved: March 23, 1976 (IBRD)

GAMBIA

TOURISM: The components of this tourism infrastructure project are: (a) extension of an access road and construction of secondary roads and paths between resort sites and within adjacent villages; (b) extension of telecommunications facilities to the resort area; (c) construction of a sewerage system to serve the resort area; (d) construction of public facilities and market stands for the sale of local handicrafts, fruit, and other goods at the resort sites; (e) establishment of a hotel training school and facilities, (f) establishment of a food storage and marketing program to increase the amount of locally produced food purchased by hotels; (g) funds for the project management unit, a program of tourism investment promotion, and two studies, one on the social, economic and fiscal impact of the anticipated tourism development and one on the possibility of using groundnut shells as an alternative to imported oil for generating electric power. The public utilities development components are (a) expansion and improvement of the electric power and water supply systems in the Banjul/Kombo St. Mary area including the resort area; (b) equipment for converting existing electricity generators to use heavy fuel oil and construction of a fuel storage reservoir and facilities to pump heavy fuel from the reservoir to Gambia Utilities Corporation (GUC's) generators; (c) consulting services and technical assistance to strengthen the GUC.

Borrower: Republic of Gambia, The Gambia Utilities Corporation (GUC).

Loan: $4.0 million; 50 years at 0.75 percent per annum. Total cost: $8.8 million.

Purpose and Benefits: The project provides infrastructure and services to improve public utilities facilities in Banjul and promote the development of tourism. It will also increase the share of the Government and Gambian nationals in the benefits from the tourism industry. It will improve living conditions in the labor support areas, provide hotel training facilities, and help promote sales of local products to hotels and visitors.

Date approved: December 30, 1975 (IDA)

AGRICULTURE: Over a four-year period, this project aims to increase the cereal and cash crop production and livestock husbandry of some 48,000 people, living in 65 selected villages (2,200 compounds). Increased production would be achieved through better-coordinated and strengthened government services, improved communications and marketing, and the introduction of proven package programs for crop production. Project implementation will be through existing agencies and departments of the Government, with project actions being coordinated by a Project Coordinator located in the Ministry of Agriculture and Natural Resources and responsible to the Permanent Secretary.

Borrower: Gambia, Ministry of Agriculture and Natural Resources (MANR).

Loan: $4.1 million; 50 years at 0.75 percent per annum. Total project cost: $11.7 million.

Purpose and Benefits: The project's direct economic benefits would be an increase in the production of groundnuts, rice, sorghum and meat. The net contribution of the project to foreign exchange earnings, through export expansion and import substitution (rice) would be $2.0 million per year at full production. The weighted average economic rate of return for the project as a whole is 23 percent. The livestock component which costs $1.6 million (15 percent of project cost before price contingencies) has an estimated rate of return of 45 percent. The crop production component costing $8.8 million (85 percent of project cost before price contingencies) has an estimated economic rate of return of 17 percent. The crop production component of the project is intended to help some of the poorest farmers in The Gambia whose present per capita income is only about $65. Per capita incomes would on the average increase in real terms by 200 percent. In addition to raising compound members' incomes to the national rural average, the project would stimulate an increase in per capita cereal production from an annual average of 200 kg to about 300 kg, thus ameliorating nutrition.

Date approved: June 15, 1976 (IDA)

GHANA

INTERMEDIATE CREDIT INSTITUTION: Established in 1963, the National Investment Bank (NIB) is the most important institution providing medium and long-term finance to industry. In addition to granting medium and long-term loans, purchasing equity or giving guarantees, NIB encourages and facilitates the participation of other sources of capital in the enterprises it finances.

Borrower: National Investment Bank (NIB).

Loan: $10 million; 15 years at 8.5 percent per annum.

Purpose and Benefits: The NIB is conscious of the importance of encouraging Ghanaian entrepreneurs, including small and medium investors, and it should be able to exercise important promotional influence at a time when the Government itself is engaged in supporting private initiative in the economy. Forty-one investment projects are in an advanced stage of study in the NIB and another 132 are under preliminary investigation. However, the shortage of foreign exchange continues to be the most important constraint in financing these efforts and the proposed loan should help to attract other foreign financing.

Date approved: December 11, 1975 (IBRD)

AGRICULTURE: The project would include: (a) replanting and maintaining during the project period about 30,000 acres of cocoa through provision of farm inputs and of credit to cocoa farmers for hiring labor; (b) training of farmers and project staff in modern cocoa production techniques and practices; (c) establishment of a project unit within the Ministry of Cocoa Affairs to plan and manage the project; and (d) provision of equipment for feeder roads and the planning of future feeder roads improvements.

Borrower: Republic of Ghana, Ministry of Cocoa Affairs.

Loan: $14.0 million; 30 years at 8.5 percent per annum. Total project cost: $21.9 million.

Purpose and Benefits: The project is an important phase of the Government's program to increase the production of cocoa, Ghana's leading export commodity and foreign exchange earner and single most important source of Government revenue. The project would increase cocoa production by 10,000 tons annually with a gross foreign exchange value of $10.8 million when the new trees reach full bearing. At full maturity, Government revenues derived from the project would be $2.4 million during the servicing of the Bank loan and $2.7 million thereafter. Further, the project would have a significant impact on the level of economic activity in Ashanti through its multiplier efforts. The project would benefit about 10,000 farm families involving some 70,000 persons. It is estimated that on the basis of the present producer price, $13.9 per 60 lb. head load, farmers would increase their incomes by $50.2 per acre during the debt repayment period (i.e. up to year 18) and by $110.8 per acre thereafter. Moreover, the project would assist the Government to focus on critical policy issues, the resolution of which is essential for the restoration of the cocoa sector. The economic rate of return to the project is estimated at 21 percent.

Date approved: December 23, 1975 (IBRD)

TRANSPORTATION: This project will include: (i) a four-year road maintenance program and training of Ghana Highway Authority (GHA) staff; (ii) reconstruction of the Achimota-Nsawam road; (iii) financial and technical assistance to the Bank for Housing and Construction (BHC) for equipment procurement and for development of private domestic road contractors and quarry owners, and (iv) studies in road building materials, optimum feeder road investment and appropriate labor/equipment mix in maintenance operations.

Borrower: Republic of Ghana, Ghana Highway Authority (GHA) and Bank for Housing and Construction (BHC).

Loan: $28.0 million ($18.0 million from IBRD and $10.0 million from IDA); 25 years at 8.5 percent and 50 years at 0.75 percent per annum respectively. Total project cost: $35.8 million.

Purpose and Benefits: The economic return from investments in road maintenance and rehabilitation has been conservatively quantified on the basis of vehicle operating costs only. The first four-year phase of the planned eight-year maintenance program is estimated to have an economic return of more than 50 percent. Reconstruction of the Achimota-Nsawam road has an economic return of about 13 percent. Additional institution-building benefits are an important project objective, but have not been quantified. These benefits include strengthening GHA, promoting the development of BHC, and assisting the development of the domestic construction industry.

Date approved: December 23, 1975 (IBRD/IDA)

AGRICULTURE: The project will cover the Upper Region of Ghana, and will affect, directly or indirectly, the region's 125,000 farmers; direct beneficiaries could vary between 60 to 90 percent of total farmers. The project would cover an investment period 1976/77 to 1980/1981 and includes: (i) farm development services, (ii) ranch and livestock development, (iii) training and communications, (iv) physical infrastructure, (v) institutional support, and (vi) development planning.

Borrower: Republic of Ghana.

Loan: $21.0 million; payable over 25 years, including 7 years of grace, at an interest rate of 4.85 percent per annum. Total project cost: $54.6 million.

Purpose and Benefits: The project should benefit most of the region's farmers through a reliable input delivery service, advance husbandry practices, and an improved agricultural extension service. Under the assumption that all farmers in the region would benefit equally from the increased production, the project at full development would increase average farm income from crop production by 32 percent from the present $243 annually to $322. This would represent a 6 percent annual increase in per capita income over the project development period, from $36 to $47. Livestock production could increase average farm family income even more from presently negligible cash income to as much as $70 per year by 1990. The overall economic rate of return is estimated at 40 percent. The project would result in net incremental foreign exchange earnings equivalent to $23 million per annum at full development in 1981, and would require the equivalent of 22,000 man-years of additional farm labor input, some of it paid labor, thereby substantially reducing underemployment in the rural areas of the Region.

Date approved: June 22, 1976 (IBRD)

GREECE

AGRICULTURE: The project consists of (1) construction of 15 new concrete lined primary irrigation canals, with a combined length of about 140 km; (2) rehabilitation and concrete lining of about 42 km of existing main irrigation canals and about 1,490 km of secondary and tertiary irrigation canals; (3) rehabilitation or renovation of about 1,065 km of secondary and tertiary drainage channels; (4) establishment of 9 small regulating reservoirs and a small diversion structure with flood bypass; (5) minor land leveling on about 4,800 ha; (6) installation of 5 irrigation pumping stations and 3 drainage pumping stations; (7) construction of about 14 new deep wells equipped with electric pump units; (8) installation of about 36 km of 15–20 kV power transmission lines; and (9) construction of about 1,110 km of farm access roads; (10) equipment for the operation and maintenance of the canals and for extension services to farmers; and (11) training and consultancy services.

Borrower: Greece, Ministry of Agriculture.

Loan: $40 million; 15 years at 8.5 percent per annum. Total project cost: $89.8 million.

Purpose and Benefits: The project will upgrade and expand irrigation facilities in central Macedonia, with fruit production increasing by 40 percent and vegetable and alfalfa production doubling. The quantifiable benefits of the project would include increased output, foreign exchange earnings and employment. At full development in 1987, the projected net value of incremental production, at 1975 prices, would be about $17 million. The average annual net income for a typical farm family (averaging 4.5 persons) operating a farm of 2 ha, with

GREECE—Continued

orchards, is estimated to be about $4,900, as compared to the present income of $2,800. A similar average farm family with a smaller irrigated farm (1 ha) cultivating mainly annual crops would have an annual income of about $1,900, compared to the present income of about $1,200. These represent increases of 72 percent and 58 percent, respectively, for the nearly 14,000 families whose current per capita incomes are less than one third the national average. The project would also provide increased employment opportunities for these families, which are presently underemployed, besides increasing the requirement for hired labor by 64 percent or 3,200 man-years, each year. The economic rate of return is estimated at 18.5 percent.

Date approved: August 19, 1975 (IBRD)

TRANSPORTATION: This project comprises: (1) construction and improvement, and related supervision, of the Patras-Pyrgos-Olympia road (100 km); (2) technical assistance (about 170 man-months) to the Ministry of Public Works for the development and implementation of an organization for improved highway maintenance and maintenance planning procedures, and coordination of feasibility studies; (3) feasibility studies of the (i) Cambos Despoti-Metsovon-Votonosi; and (ii) Corinth-Kalamata via Tripolis roads; and (iii) feeder roads linking villages in the Klidi agricultural area to the national road network (totaling 295 km), and technical assistance for 40 man-months; (4) fellowships abroad (about 240 man-months) for Ministry of Public Works senior and middle management; and (5) technical assistance (about 100 man-months) to the Ministry of Coordination and Planning for the establishment and strengthening of a secretariat to a national transport coordination committee.

Borrower: Greece, Ministry of Public Works.

Loan: $30 million; 15 years at 8.5 percent per annum. Total project cost: $64.7 million

Purpose and Benefits: The proposed road will meet the growing transport demand in one of the main agricultural areas in Greece, which includes the area served by a Government-financed irrigation project presently under implementation. The section between Patras and Pyrgos will serve as the main highway artery for traffic between the northern and southern parts of western Peloponnese. Its continuation from Pyrgos to Olympia will serve as a tourist access road to the archaeological sites at Olympia. At the same time, the road will bypass 22 villages and towns which are bottlenecks on the existing road. The main direct benefits from road construction would be savings in transport costs for highway users. Based on a construction period of 3 years, an economic life of 20 years and the estimated economic costs of project preparation, construction and supervision, the overall economic return (ER) of road construction (which will cost $44.2 million) is estimated at 20 percent, with a first-year return of 15 percent. The ERs of the Patras-Pyrgos and Pyrgos-Olympia sections are estimated at 21 and 19 percent respectively.

Date approved: April 6, 1976 (IBRD)

GUATEMALA

EDUCATION: The project consists of: (i) the establishment of 11 new, and extension of 3 lower secondary schools, 2 new and extension of 1 combined upper and lower secondary school, 2 new common facilities centers, and 2 new agricultural training schools; (ii) additional equipment and teaching materials for existing schools; (iii) extensive in-service and pre-service training programs for teaching and administrative staff; (iv) technical assistance in the equivalent of 11 man-years of specialist services and about 45 man-years of fellowships; and (v) studies to map existing educational resources and to determine future priority investment needs in education, and establishment of a tracer system to followup school graduates.

Borrower: Republic of Guatemala, Ministry of Education.

Loan: $14.5 million; 30 years at 8.5 percent per annum. Total project cost: $22.1 million.

Purpose and Benefits: The project is designed to assist the Government in implementing more fully the educational improvements supported by the first project. Its major objective, therefore, is to enable the secondary education system to provide students with a more practically oriented education and thus provide them with skills for further on-the-job training or further studies more relevant to national development needs. In addition, the proposed agricultural training schools would prepare technicians needed to upgrade agricultural knowledge and skills in some of the most backward rural areas. Most project schools would function as community training centers available for nonformal training programs, and both first and second project schools would be assisted through teacher and administrator training programs, and through technical assistance to implement new curricula.

Date approved: February 17, 1976 (IBRD)

GUINEA

TRANSPORTATION: Project components comprise: (a) rehabilitation of 2,491 km 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 (i) highway equipment and spare parts, (ii) workshop equipment and tools, (iii) parts for repair of existing equipment and plant, (iv) engineering and laboratory equipment and training materials, and (v) radio equipment; (d) purchase of materials and supplies for project operations; and (e) technical assistance to the Ministry of Public Works, Mining and Geology for the implementation of the project, the training of mechanics and equipment operators, and the preparation of a second phase of the rehabilitation and maintenance program to be executed over 1978/79—1980/81.

Borrower: Republic of Guinea, Ministry of Public Works, Mining and Geology.

Loan: $14.0 million; 50 years at 0.75 percent per annum. Total project cost: $18.6 million.

Purpose and Benefits: The success of the Government's efforts to revitalize the agricultural sector will depend partly on the availability of an efficient and reliable transport system linking the widely dispersed population centers and productive areas, and between these centers and the Port of Conakry. As roads provide the predominant means of transport, the highest priority requirement of the transport sector consists of the preservation, by rehabilitation and subsequent regular maintenance, of the road network. The quantifiable benefits included in the analysis are (i) the reduction in vehicle operating costs and avoidance of future increases; and (ii) the savings in delaying the need for road reconstruction. The economic life of the project has been estimated to be 10 years, reflecting the estimated economic life of rehabilitation works. The project has a benefit/cost ratio of 4.6 with the stream of costs discounted at 12 percent; this corresponds to an economic return which exceeds 100 percent and indicates that the project is long overdue.

Date approved: December 23, 1975 (IDA)

HAITI

EDUCATION: These loan funds will help construct, furnish and equip 65 rural and 10 urban primary schools/community learning centers and will help to extend one and two new primary teacher training colleges, finance equipment for rural literacy and community development programs, and provide seven man/years equivalent of technical assistance and one man/year equivalent of fellowships and assistance for project administration.

Borrower: Republic of Haiti, Department of Agriculture and Department of National Education.

Loan: $5.5 million; 50 years at 0.75 percent per annum. Total project cost: $6.5 million.

Purpose and Benefits: The project would increase educational opportunities for children and adults mainly in two rural areas, upgrade the qualifications and expand training facilities for primary teachers, modernize the primary and teacher training curricula and help improve educational planning, administration and supervision. There are some risks that the longer-range objectives of generalized curriculum reform and nation-wide upgrading of teacher qualifications may not be realized unless the Government adopts specific plans and makes adequate allocations of scarce financial and human resources. To pursue these objectives the Government, with the assistance of qualified experts, will prepare an education development plan by June 30, 1977 on the basis of a statement of long-term objectives agreed with the Association. Together with the Association, the Government will annually review implementation programs and future resource needs.

Date approved: February 24, 1976 (IDA)

POWER: The project will help finance the construction and equipping of a medium-speed diesel engine power station with a capacity of about 21 MW, a training center, and transmission and distribution works of: (i) 21 km single-circuit 69 kV transmission line; (ii) 5.4 km of double circuit 115 kV transmission line; (iii) extension of an existing 115 kV substation and construction of new 115/69/12.47 kV and 69/4.16 kV substations; (iv) extension and rehabilitation of existing transmission and distribution networks; and (v) improvements to the security of the existing transmission system between the Peligre hydropower station and Port-au-Prince. Technical assistance for engineering and supervision and for training of Electricite d'Haiti (EdH) personnel is also included in the project.

Borrower: Haiti, Electricite d'Haiti (EdH).

Loan: $16.0 million; 50 years at 0.75 percent per annum. Total project cost: $18.0 million.

Purpose and Benefits: Projections for power demand and generation for Port-au-Prince have been made by the consultants through 1990. These projections take into consideration an expected reduction in electricity losses from the present 32 percent of total net generation to 16 percent by 1982 through enforcement of the new anti-theft legislation and improvement of the distribution system. Though present forecasts indicate a need for additional diesel plant and transmission/distribution facilities to be built in 1978, demand patterns will be closely monitored in order to ascertain more precisely the need for future power investments. For the short term it is clear that there is an immediate need for additional generating capacity, as loads totalling 14 MW are already awaiting connection and, even without connecting these loads, there would be power shortages in the 1977 dry season. The new generating plant would become fully operational toward the end of 1977. In a study by the consultants comparing (1) medium-speed diesel engine plants, (2) gas turbine engine plants, and (3) a combination of gas turbine and steam plants, the medium-speed diesel engines were found to be the least cost solution for discount rates of up to 20 percent. The transmission works selected for the proposed project were the least cost solution for discount rates of up to 35 percent. The economic rate of return of the project would be about 16 percent.

Date approved: June 17, 1976 (IDA)

HONDURAS

AGRICULTURAL CREDIT: This project will help finance dual purpose beef/dairy farms, livestock fattening operations, annual and perennial crop production; the rehabilitation and improvement of the Isleta agrarian reform settlement; development of small agro-industrial enterprises, and the provision of farm development contractor services. The project will also finance a technical assistance program which would include the recruitment of specialists to assist in the strengthening applied research and extension through the Ministry of Natural Resources (MRN); equipment and specialists to strengthen the Instituto Nacional Agrario's (INA) program for developing agrarian reform settlements; project preparation studies for future agrarian reform projects by acceptable consulting firms; additional staff and equipment for the Pan American Agricultural School (PAS) to provide training to beneficiaries; and equipment for the Central Bank Project Credit Unit which would administer the project.

Borrower: Honduras, Central Bank.

Loan: $14.0 million; 50 years at 0.75 percent per annum. Total project cost: $20.0 million.

Purpose and Benefits: The project focuses on products which have a direct foreign exchange earning potential, such as bananas and beef, or which would substitute for imports, such as rice and milk. The overall economic rate of return is estimated to be 41 percent. The project would provide additional on-farm employment for about 2,900 low income people. Off-farm employment in agro-industries or supporting services would directly employ an additional 100 persons. With their dependents there would thus be some 17,600 labor beneficiaries.

Date approved: May 18, 1976 (IDA)

INDIA

POWER: The project consists of rural electrification schemes to be undertaken by the Rural Electrification Corporation (REC) during the Fifth Five-Year Plan period, ending in March 1979. REC's program over this period is projected to be about $800 million. Rural electrification schemes which are submitted by eligible State Electricity Boards (SEBs) and meet REC's criteria will be eligible for financing under the credit. About 140 schemes covering a total of $114 million are expected to receive assistance under the credit. More than half of the

INDIA—Continued

connected loan would be for irrigation pumping; the balance would be for small industries and domestic and commercial connections. The REC, an autonomous company under the general supervision of the Ministry of Energy, was established in 1969 to channel funds to SEBs for rural electrification development. Of its original capital of Rs 1,500 million, 70 percent was provided by a grant from the United States and the balance from the Government of India. All these funds and more have now been used for REC for some 958 rural electrification schemes sanctioned as of March 31, 1975, and the Corporation needs additional funds to carry on its business.

Borrower: India, Rural Electrification Corporation (REC).

Loan: $57.0 million; 50 years at 0.75 percent per annum. Total project cost: $114.1 million.

Purpose and Benefits: The project would benefit about 55,000 farmers and their dependents and about 210,000 domestic/commercial consumers in 6,250 villages. The main economic benefits would result from increased agricultural production. Irrigation pumpsets, for which electrical power is generally more economical than diesel power, would enable farmers to intensify land use and to raise output through the use of high yielding seed varieties. Other benefits would accrue from the expected establishment of small industries, especially agro-industries, and thereby the creation of new employment opportunities. There would also be social benefits such as the many uses of electricity in rural villages and households and the possible curbs on urban migration. Based on the value of incremental output from agriculture and small industry and the expected revenues from domestic and commercial consumers, the economic rate of return on investment in a typical REC-financed project is estimated at 23 percent. While this is the return from a typical REC scheme, there will be substantial variations depending upon the conditions prevailing in different states but it is not expected that schemes that meet REC's criteria will show an economic rate of return of less than 10 percent.

Date approved: July 8, 1975 (IDA)

TRANSPORTATION: The loan will finance part of the investment program of the Indian Railways (IR) for the two years 1975/76 and 1976/77. The project consists of new and ongoing works required to meet projected increases in demand for freight and passenger services and to continue with cost reduction measures, including modernization of equipment. It also includes necessary spare parts for maintenance of locomotives and rolling stock. The main elements of the project include procurement of equipment, materials and components essential to the manufacture of 350 locomotives, about 300 electric multiple units, about 1,500 coaches and about 20,000 wagons (four-wheeler equivalent), and for electrical, track and other works:

Borrower: India, Indian Railways (IR).

Loan: $110 million; 50 years at 0.75 percent per annum. Total project cost: $1,010.0 million.

Purpose and Benefits: The objective of IR's fifth five-year investment program (1974/75–1978/79) is to provide capacity for increased traffic, to improve efficiency and to reduce costs. The program has been directed towards the transportation of bulk materials such as coal, iron ore, steel, cement, fertilizer and petroleum products, which account for 80 percent of railway freight. The project includes 209 major sub-projects, each exceeding $0.6 million in cost. These represent about 50 percent of IR's total investment; most of the balance will be allocated for rolling stock. IR's project evaluation procedures were found to be satisfactory, and the return on investments varied between 10 percent and 25 percent. The overall economic rate of return on IR's five-year investment program is estimated at about 20 percent; the program responds to the priority needs of India's economy.

Date approved: August 19, 1975 (IDA)

WATER SUPPLY AND SEWERAGE: The funds will assist in the reorganization of the water supply and sewerage sector in the State of Uttar Pradesh, the construction of water supply schemes in selected rural areas suffering hardships due to inadequate water supply, and the improvement of water supply and sewage systems in the five largest cities of the State ("the KAVAL towns").

Borrower: India, Government of Uttar Pradesh, (Jal Nigam—Uttar Pradesh State Water Supply and Sewerage Development Corporation).

Loan: $40.0 million; 50 years at 0.75 percent per annum. Total project cost: $75 million.

Purpose and Benefits: Only one-third of UP's present population—which, at 95 million, is larger than that of any of the Bank's borrowers except Brazil, Indonesia, and India itself—has access to safe water supplies and the present rate of investment in the sector is not sufficient to keep pace with the annual growth in population. Therefore, there are dangers of large-scale outbreaks of water borne diseases and increasing hardship due to a lack of drinking water for large masses of people. Available data on health and disease, although limited, emphasize the urgent need to improve the quantity and quality of water supplies in Uttar Pradesh. Diseases which are almost eliminated in many parts of the world are virtually endemic in UP. Pilot water supply projects in UP have successfully reduced the local incidence of diseases and mortality rates reducing diarrhea in children under five from 24% to 5% in four years, eliminating typhoid, and reducing deaths from dysentery from 12.2 to 3.1 per 1,000 population. Rapid coverage of the entire population is not feasible, but even modest increases in the percentage of the population covered would yield substantial benefits. In a drive to place the sector on a self-supporting basis, this loan is the first significant step in establishing the institutional and financial mechanisms for improving the situation.

Date approved: August 19, 1975 (IDA)

INDUSTRY: The project is concentrated entirely on improving the utilization of existing fertilizer production capacity in India. The credit would assist ten fertilizer plants in removing production bottlenecks, improving pollution control and increasing the production of industrial chemicals. It would also assist in increasing the capacity of one refinery to produce petroleum feedstock for the fertilizer industry. In terms of incremental production, the project would increase fertilizer output by 253,000 metric tons per year (TPY) of nutrients, raising production in the ten plants by an average of 13 percent of their combined capacity.

Borrower: India.

Loan: $105 million; 50 years at 0.75 percent per annum. Total project cost: $146.3 million.

Purpose and Benefits: By removing production bottlenecks and permitting India to better utilize her industrial potential, the project represents a significant step toward an efficiently operating fertilizer industry. Together with other modernization schemes now being implemented, it would allow production in existing facilities to be raised from the present industry-wide average of about 60 percent of capacity to 85–90 percent by 1979, thereby increasing returns on prior investment. Its incremental output of fertilizer would help increase India's foodgrain production by about 1.5 million tons annually. The financial rate of return for the 17 components whose benefits have been quantified (excluding the Zuari anti-pollution sub-project, the pollution control and testing equipment for the Fertilizer Corporation of India (FCI), and technical assistance) ranges from 14 percent to over 60 percent. Taking the cost and benefit streams of the 17 sub-projects together yields a composite financial rate of return for the project of 26 percent. The composite economic rate of return for the project, based on the 17 components with quantifiable benefits, is 32 percent (ranging from 18 percent to over 60 percent for individual components), based upon a projected 1978 f.o.b. price of urea of 160 per ton (in constant 1975 dollars). The economic value of the additional fertilizer output alone is about US$117 million annually, and the annual net economic benefit about US$84 million.

Date approved: December 16, 1975 (IDA)

FORESTRY: The project provides technical assistance, over a five-year period, to enable the borrower and the State of Madhya Pradesh to develop and prepare wood processing programs based on the forest resource in the Bastar district of Madhya Pradesh. The project comprises a major industrial feasibility study to provide the basis for determining the location, size and configuration of forest industries that could be established and would include a program of research trials, pilot operations and studies to solve the technical, economic, environmental and sociological problems that would arise from large scale clearfelling and reforestation.

Borrower: India.

Loan: $4.0 million; 50 years at 0.75 percent per annum. Total project cost: $8.2 million.

Purpose and Benefits: The objectives of the technical assistance project are to identify a sound resource base for pulp and paper and related industries; and while these industries are under construction, to develop and explore satisfactory logging methods, species and planting methods for fast growing plantations so that, when large scale felling operations begin to supply the proposed pulpmills, the clear-felled areas can be efficiently logged and replanted with fast growing industrial plantations.

Date approved: December 30, 1975 (IDA)

POWER: The major part of this project (Part A) forms part of a US$509 million program of investment in high-voltage power transmission during the period 1976/77—1978/79 by the four beneficiary State Electricity Boards (SEB's)—those of Maharashtra, Gujarat, Bihar and West Bengal—and load despatch facilities being constructed by the Eastern and Western Regional Electricity Boards. This component will consist of about 2,800 circuit km of 220 kv overhead transmission lines, some of which are designed for later conversion to 400 kv operation; about 15 km of 220 kv and 132 kv underground cables; and equipment to increase the aggregate capacity of 30 substations by about 2,700 MVA. Also included are capacitors or synchronous condensors to help improve system operations, and power line carrier communication and telemetering equipment to further improve existing communication and load despatch facilities in the States' systems. Another part of the project (Part B), for which US$30 million of the credit would be allocated would meet the cost increases incurred under the Third Power Transmission Project. Credit 377-IN helped to finance similar transmission investments by eleven other beneficiaries: the SEBs of Assam, Karnataka, Kerala, Madhya Pradesh, Orissa and Tamil Nadu; the Delhi Electricity Supply Undertaking; the Beas Construction Board; the Southern and Northern Regional Electricity Boards; and the Tata Power Company, a private company in Bombay.

Borrower: India.

Loan: $150 million; 50 years at 0.75 percent. Total project cost: $207.3 million.

Purpose and Benefits: The basic justification for this investment in transmission facilities is to permit better utilization of existing generating capacity and to complement investment in new generation plant. The investment would support the development of a system which will maximize the utilization of existing and new capacity and minimize the uncertainties and interruptions of power supply by providing flexibility in power despatch according to priority load demands. It is of course not possible to isolate the benefits of the particular transmission sub-projects under consideration here from those of the transmission and generation improvements underway as a whole in each of the State systems involved. It can only be emphasized, against the background of heavy losses to the economy from power shortages in the last few years, that the benefits in production from increased and more reliable power supplies will be very high. Beyond this, and in the longer run, the project will also contribute significantly to the growth of inter-State and inter-regional transmission systems. Only with the eventual development of an adequate, integrated generation and transmission system will it be possible for India to overcome fully the constraint of power supply shortages which has plagued industrial and agricultural development for the past several years.

Date approved: January 13, 1976 (IDA)

AGRICULTURE: The project would demonstrate practical and effective means of increasing cotton yields and maximizing by-product recovery from ginning and cottonseed processing, and would be executed over five years. It would involve the following components: (i) accelerated research to breed more suitable and higher-yielding cotton varieties and the production of breeder and foundation seed of recommended varieties; (ii) improve production from the use of certified seed, more intensive plant protection services, and cultural practices; (iii) modernization and expansion of ginning and cotton seed processing; (iv) provision of a revolving fund for incremental seasonal credit to growers; and (v) training program.

Borrower: India, States of Haryana, Maharashtra, and Punjab; Agricultural Universities of Haryana, Maharashtra and Punjab; Indian Council for Agricultural Research (ICAR); and Agricultural Refinance and Development Corporation (ARDC).

Loan: $18 million; 50 years at 0.75 percent per annum. Total project cost: $36 million.

Purpose and Benefits: Major benefits would accrue through increased yields arising from higher-yielding seeds, improved plant protection, better access to growers' credit, and increased ginning and processing efficiency. The incremental increase in output over twenty years would be about 0.8 million tons of higher quality lint and 1.5 million tons of cottonseed with a gross value of about US$750 million. Agricultural beneficiaries would include about 120,000 farm families and 200,000 landless laborers, the vast majority of whom are from very low-income families, engaged in the production and harvesting of cotton. An additional 2,000 jobs would be created in marketing and processing. Investments in the improvement and expansion of the project area cotton ginning industry would increase the value of lint ginned by about Rs 560 (US$70) per ton. Investments in the cottonseed industry would enable the conversion of 1.5 million tons of seed into higher quality by-products. All of the edible oil recovered, about 250,000 tons valued at US$250 million (1980 price estimate), would substitute for imports. The recovery of linters, hulls and cottonseed meal would provide valuable by-products which are currently wasted. The economic rate of return ranges from 10 percent for ginners and 34 percent for cottonseed processing plants to rates over 100 percent for the on-farm plus extension and research investments. The weighted average rate of return for the whole project is also over 100 percent.

Date approved: January 27, 1976 (IDA)

NON-PROJECT: This credit is designed to finance three main categories of imports. The first category is to support export development through assisting in the cost of financing import replenishment licenses for exporters; this is the first time that this type of assistance has been proposed under these industrial import credits. The second category is to support industries which are vital to the economy while also having export potential. Finally, the third category includes support for those industries which are vital to the priority sectors of agriculture and power. The combined list of eligible industries emerging from the last two categories does not differ very markedly from the lists under previous credits, although there has been some modification of industry groups and aluminum smelting and manufacture of heavy construction equipment have been dropped; the former because the special need for funds no longer exists and the latter because of the downturn in demand.

Borrower: Government of India.

Loan: $200 million; 50 years at 0.75 percent per annum. Total project cost: $305 million.

Purpose and Benefits: The need for program assistance is based on an assessment of two general factors, India's needs and the Government's own effort to promote development especially in the areas of agriculture, energy and exports. India's need for assistance requires little amplification. India has one of the lowest per capita incomes. It ranks among the countries most affected by the oil crisis and commodity inflation; and it has to endure the vagaries of the monsoon the failure of which can have such devastating effect. In the past, the Association has emphasized the difficulty of India's domestic resource situation, the inadequate foreign exchange available to supplement these domestic resources, and thus India's need for aid. Approval of this further credit will assist the Government to ensure an uninterrupted flow of maintenance imports for the industrial sector.

Date approved: February 24, 1976 (IDA)

IRRIGATION: The purpose of this project is to complete the on-going construction of irrigation infrastructure in the Nagarjunasagar irrigation system, and to provide the first stage (covering three years) of command area developement for four major irrigation systems in Andhra Pradesh (Nagarjunasagar Right and Left Bank Commands, Pochampad irrigation system, Tungabhadra High Level Canal Command). The project consists of (i) completion of the Nagarjunasagar (NSP) Left Main Canal (about 65 miles) and construction of irrigation and drainage facilities for the NSP Left Bank area; (ii) completion of the Nagarjunasagar Right Main Canal (about 29 miles) and construction of irrigation and drainage facilities for the NSP Right Bank area; (iii) rehabilitation, upgrading or construction of about 1,575 km of village roads in the NSP command area; (iv) command area development covering 72,000 hectares of land in the four major irrigation systems mentioned above; (v) a program to monitor water use efficiencies in NSP and crop yields in the four project areas; (vii) extension service assistance; and (viii) assistance for a project preparation and evaluation group in India's Ministry of Agriculture and Irrigation.

Borrower: India, State of Andhra Pradesh.

Loan: $145 million; 25 years at 4.5 percent per annum. Total project cost: $297.0 million.

Purpose and Benefits: The Command Area Development (CAD) and extension programs which make up the first component are expected to raise average yields by 50%; the CAD program itself will increase farm irrigation efficiencies from about 45% to 65% for lands classified as "irrigated/dry," and will, therefore, lead to water savings of about 2,500 m^3 per hectare; the water that is saved will be used to increase irrigation intensities. The extensions of the Left Bank and Right Bank Canals form the basis for some of the benefits to be derived from the CAD and extension programs, and will provide additional water to 100,000 farm households and additional employment and wages to 1.1 million people. At ultimate development, annual production in the project area would be increased: of rice, by 327,000 tons to 1,531,000 tons; of cotton, by 105,000 tons to 172,000 tons; of groundnuts, by 193,000 tons to 305,000 tons; of maize, by 70,000 to 122,000 tons; and of sorghum, by 756,000 tons to 858,000 tons.

Date approved: May 4, 1976 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: These loan funds will assist the Industrial Development Bank of India (IDBI) in using its refinance mechanism to finance imported goods and services required to develop small- and medium-scale industrial enterprises in India, and to improve the performance and effectiveness of the State Financial Corporations (SFCs) serving these sectors.

Borrower: India, Industrial Development Bank of India (IDBI).

Loan: $40 million; 15 years at 8.5 percent per annum.

Purpose and Benefits: This loan continues the pursuit of the objectives sought under the first credit of 1973: to finance the import component of sound, high-priority industrial projects in the small- and medium-scale sector and the upgrading of SFCs through specific programs. In the first instance, through project financing, it would contribute to the modernization of small-scale industries, the development of new entrepreneurs in backward districts, employment generation both in rural and urban areas, and an increase in exports. Secondly, the loan will provide the vehicle for the Bank's continued involvement in the upgrading of the SFC's. While the industrial distribution has been reasonably diversified, the regional distribution, as expected, showed a marked concentration on the SFC's in the most industrialized States, like Maharashtra and Tamil Nadu; nevertheless, the financial institutions in conjunction with the State authorities have conducted industrial potential surveys and have identified new industrial opportunities in less industrialized States, a number of which have already been implemented. A sample of 68 sub-projects submitted for prior approval under the first credit showed that the financial rates of return were expected to be above 20% in 75% of all cases, with an (unweighted) average at 29%.

Date approved: May 18, 1976 (IBRD)

AGRICULTURE: This project is the first phase in the development of India's National Seed Program to increase the availability of high quality seed. Project components include: reorganization of the National Seeds Corporations (NSC) to carry out its major responsibilities for overall coordination and development of India's seed industry and interstate seed marketing; provision of equipment for NSC's vegetable seed operation; expansion of seed storage capacity and establishment of a reserve stock; establishment and equipment of 4 State Seed Corporations (SSC); development of large-scale farms for certified seed production; development of university facilities for foundation seed production, processing and storage; improvement of breeder seed production facilities at agricultural universities and the Indian Council for Agricultural Research Institutes; development of seed technology research programs at agricultural universities; provision of equipment or other facilities for private seed processing corporations; expansion of quality control and certification facilities; and provision of training and technical assistance.

Borrower: India, National Seeds Corporation.

Loan: $25.0 million; 20 years at 8.5 percent per annum. Total project cost: $52.7 million.

Purpose and Benefits: The most significant risk to the project lies in the fairly complex organizational arrangements involved in project implementation which, unless carefully managed, could result in some aspects of the project moving more slowly than others. The project would provide a number of important economic benefits. The main project benefit would be increased crop yields resulting from the improved availability and quality of seed. Projected annual incremental cereal production at full development would be 200,000 tons of wheat, 170,000 tons of paddy, 95,000 tons of maize, 200,000 tons of sorghum, and 250,000 tons of pearl millet. Total value of these crops would be about $145 million per year. The project would also increase and improve the production of cotton seed, estimated to be worth about $3.7 million per year at full development. About 3 million farmers would benefit from the use of project seed. Since small farmers suffer most from supply constraints and high prices, they should benefit substantially from the improved seed supply and lower prices which should result from the project. Employment effects would be the creation of about 14,000 man years of seasonal work during harvesting and about 800 jobs to carry out the work of the SSC and Certification Agencies. Based on the quantified incremental costs and benefits, the economic rate of return to the project is about 65%.

Date approved: May 27, 1976 (IBRD)

INDONESIA

TRANSPORTATION: The project consists of investments to provide a new integrated system for the urea produced by P.T. Pupuk Sriwidjaja (PUSRI) at plants in Palembang, Sumatra, together with other types of fertilizer which will be distributed by PUSRI totaling some 1.4 million tons per annum. Specific investments to be undertaken during the project include: acquisition of three self-unloading ships of about 7,000 dwt for bulk shipments; expansion or improvement of three and provision of two new bulk unloading port terminals; construction of 59 inland fertilizer storage and distribution depots; provision of 175 railway wagons, four main line and three shunting locomotives, the latter being owned and operated by Indonesia State Railways (PJKA), and 27 railway spurs to inland storage depots; construction and procurement of office space and vehicles; technical assistance to assist and train PUSRI personnel in overall scheduling and movement control; and a study for the establishment of a National Fertilizer Distribution System.

Borrower: Republic of Indonesia, P.T. Pupuk Sriwidjaja (PUSRI), Indonesia State Railways (PJKA).

Loan: $68 million; 15½ years at 8.5 percent per annum. Total project cost: $130.0 million.

Purpose and Benefits: The distribution system is the least cost solution of all alternatives considered; it would generate benefits from a reduction in transport costs and fertilizer losses due to inadequate existing transport and storage facilities. It is estimated that about 75 percent of the total quantifiable benefits would be generated by reductions in transport and distribution costs and 25 per cent through reduced fertilizer losses compared to transport in bags. Further substantial benefits compared to the present system would accrue through the avoidance of congestion in ports and land transport; but since these benefits are not quantifiable they are not included in the calculation of the economic rate of return. The economic rate of return for the project is about 20 percent. The economic return reflects the inefficiencies of the present distribution system and the urgent need to improve it in view of the much higher tonnage to be moved. Even under various conceivable pessimistic assumptions such as project capital cost increases of up to 20 percent and benefit decreases or under-utilization of capacity of up to 20 percent, the project would still yield an economic rate of 13 percent. At present, the government subsidizes consumer prices for fertilizer; the benefits of reduced transport and distribution costs and reduced fertilizer losses could therefore be used to reduce these subsidies, or the government could choose to lower the current price of fertilizer, in which case the farmer would be the beneficiary. Farmers would also benefit from the increased reliability and quality of fertilizer supplies which would result from the project.

Date approved: July 1, 1975 (IBRD)

INDUSTRY: The project consists of two major parts: Part I includes: (a) establishment of the National Coordinating Agency for Resource Survey and Mapping (BAKOSURTANAL) at Cibinong, including suitable facilities for printing and cartographic shops and photographic laboratories; (b) procurement of cartographic, printing, imagery interpretation, and other equipment required for both map production and reconnaissance resource evaluation; (c) procurement of remote sensor imagery, including earth satellite output; (d) aerial photography at scales of 1:50,000 and above, of approximately 300,000 km to support detailed mapping of specific areas for project planning and chartering purposes; (e) technical services to be executed by survey firms, including geodetic control, photo processing and reproduction, and contract map production for delimited areas; (f) engagement of individual experts to provide technical

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assistance to BAKOSURTANAL in geodesy, aerial photography, cartography, printing processes and resource evaluation; and (g) training for BAKOSURTANAL's senior technical professional staff and staff technicians. Part II includes: (a) aerial photography at a scale of 1:100,000 of approximately 950,000 km²; (b) extension throughout Indonesia of the primary, secondary and tertiary geodetic control network to density required for 1:50,000 scale mapping; and (e) aerial triangulation of all areas flown.

Borrower: Republic of Indonesia, the National Coordinating Agency for Resource Survey and Mapping (BAKOSURTANAL).

Loan: $13 million; 20 years at 8.5 percent per annum. Total project cost: $46 million.

Purpose and Benefits: The project will make a substantial contribution to the economy of Indonesia by: (a) reducing the costs and delays incurred in the mapping and survey activities required for project preparation and specialized survey purposes; (b) improving the effectiveness of sectoral, regional, and environmental planning and policy-making; and (c) increasing the safety and efficiency of aviation and navigation. Since the mapping undertaken under the project would provide the basis for most other mapping required for purposes of planning and project implementation and would establish geodetic control for the whole country, the benefits accruing to Indonesia through cost reductions in specialized mapping programs would be considerable. The regional resource surveys would improve the productivity of investment in agriculture, transmigration and land settlement, timber and mineral extraction and related transportation infrastructure, since investment efficiency in those sectors is particularly dependent on the accuracy and coverage of natural resource information.

Date approved: January 27, 1976 (IBRD)

FOURTH EDUCATION PROJECT: The project consists of (i) the construction of and equipment for: two technical teacher training facilities and four centralized workshops under the Department of Education; seventeen vocational training centers under the Department of Manpower; new facilities for the National Institute of Administration; and (ii) equipment for one instructor training center and twenty rural and five urban mobile training units under the Department of Manpower.

Borrower: Republic of Indonesia, National Institute of Administration (LAN), Department of Education, Department of Manpower.

Loan: $37 million; 25 years including six years of grace, at an interest rate of 8.5 percent per annum. Total project cost: $65 million.

Purpose and Benefits: This project will aid in the development of technical manpower in Indonesia by: (a) increasing the output of skilled workers, and by assuring the necessary supply of qualified technical teachers; (b) expanding the capacity for non-formal vocational training at the semi-skilled worker level assuring the necessary supply of qualified instructors; (c) providing through the mobile training units the basic skills for disadvantaged rural and urban groups that would enable them to earn additional incomes to improve their livelihoods; and (d) strengthening the LAN to increase the supply of better trained civil servants at national and provincial levels, and thus provide for more effective and efficient operation of public administration.

Date approved. April 6, 1976 (IBRD)

TRANSPORTATION: The project provides for: (a) construction and supervision of about 1,100 km of road improvements; (b) screening feasibility studies of 7,000 km of roads for future road improvements; (c) detailed engineering of 4,100 km of roads in Sumatra, Java and Bali; (d) detailed engineering of the Jakarta-Cikampek road (70 km); and (e) technical assistance to Directorate General of Highways (DGH) for training, administration, and planning.

Borrower: Republic of Indonesia, Directorate General of Highways (DGH).

Loan: $130 million; 25 years, including 5 years of grace, with an interest rate of 8.5 per annum. Total project cost: $234 million.

Purpose and Benefits: The basic thrust of the DGH Betterment Program is to improve roads which were originally designed to carry a small number of light pre-World War II vehicles and now must accommodate a much larger volume of heavier traffic, aiming to avoid repeated repaving works and to further reduce vehicle operating costs by selective improvements, such as widening of carriageways and shoulders. With the gradual improvement of the main roads under the Betterment Program, maintenance funds, which presently are devoted to providing these roads with frequent repavings of limited life, will be released for other works, particularly rehabilitation of secondary roads with lower traffic volumes where simple pavement construction is more economical. It may be noted that each $1.0 million of construction work under the Betterment Program is estimated to provide 100 man-years of skilled jobs and about 100–500 man-years of unskilled jobs, depending on the nature and location of the work. Out of total construction costs, approximately 10–15 percent will probably represent payments to labor.

Date approved: April 6, 1976 (IBRD)

TRANSPORTATION: The project provides for: (a) rehabilitation of about 54,500 dwt of existing inter-island ships; (b) procurement of about 52,000 dwt tons of used cargo ships; (c) procurement of about 50,250 dwt of new standard cargo and cargo-passenger ships; (d) scrapping of about 70,000 dwt of existing inter-island ships; (e) a technical assistance and training program to support and improve inter-island fleet operations and planning and to train marine officers and engineers; (f) a study to determine further needs for Regular Liner Service (RLS) shipping during Repelita II and beyond.

Borrower: Republic of Indonesia, P.T. PANN (Pembangunan Armada Niaga Nasional-National Fleet Development Company).

Loan: $54.0 million. The terms are for 15 years including three years of grace, at an interest rate of 8.5 percent per annum. Total project cost: $195.2 million.

Purpose and Benefits: Implementation of many programs in REPELITA II depends to a large extent on improved shipping services. The transmigration of people from Java to other islands, improved agriculture and development of agriculture-based industries in the outer islands, and exchange of processed goods and raw materials between Java and the other islands, all depend on shipping. This project will help improve management capabilities of public or private organizations involved in the maritime sector through technical assistance and training programs. The economic rate of return on the overall project would be about 18 percent; 19 percent on used ships costing $41.2 million and 15 percent on new ships totaling $124.2 million. A program mixture of new and used ships and rehabilitation would allow the Government to begin ship standardization, improve the age distribution of the existing fleet and to provide work for Indonesian shipyards. This is expected to result in an average ship productivity increase from only 9 to 10 cargo tons per dwt in 1972 to at least about 15 tons per dwt in 1979.

Date approved: May 4, 1976 (IBRD)

INDUSTRY: The loan funds will help finance the detailed engineering, construction and start-up of a fertilizer plant at Palembang, Sumatra, to manufacture about 1,000 TPD (tons per day) of ammonia and 1,725 TPD of urea; training of PUSRI's staff and staff employed in the national fertilizer industry in Indonesia in the operation and maintenance of plant, as well as in financial and accounting procedures. The plant's facilities would include: (a) a single-train ammonia unit with a capacity of about 1,000 metric tons per day; (b) a single-train urea unit with a capacity of about 1,725 metric tons per day; (c) a natural gas pre-treatment section; (d) the usual off-sites and auxiliaries required to support such plant, including, *inter alia,* an ammonia storage tank, urea storage and loading facilities, cooling towers, water treatment facilities, a 15 MW gas turbine power generator, a bag-making plant and expansion of the existing jetty.

Borrower: Indonesia, P.T. Pupuk Sriwidjaja (PUSRI).

Loan: $70 million; 15½ years at 8.5 percent per annum. Total project cost: $186.0 million.

Purpose and Benefits: During the late 1960's, world fertilizer prices were depressed due to excess supply and consequently, investments in new fertilizer projects declined sharply. The widespread realization in the early 1970's of the production possibilities of high yielding varieties of seeds used in combination with other agricultural inputs led to a rapid increase in the demand for fertilizer, which was not matched by increased supply. As a result, fertilizer prices increased steeply; the price of urea increased to about $300 (f.o.b. exporting countries) per ton in 1974 compared to about $70 per ton at the end of the 1960's. However, after some importing countries built large stockpiles and then stopped buying, prices declined and reached the level of about $110–150 per ton by April 1976. World fertilizer prices are likely to remain at the present levels until the stockpiles are used up and imports are resumed, but the large-scale expansion at higher investment cost per ton of capacity required to meet future urea demand in the world would require a selling price of $160–190 (f.o.b.) per ton of urea in 1975 dollars. Deferment of investment in new urea projects due to prevailing low prices may again result in shortages leading to sharp price increases as experienced during 1973–74. Therefore, fertilizer-deficit countries have to depend on increased domestic production to combat periodic surges in world fertilizer prices. The economic rate of return of the project has been estimated at about 29 percent. The project would augment annual urea production by 513,000 tons and would contribute to an increase in rice production of about 2 million tons annually. Further, the net foreign exchange savings at full production would amount to $72 million annually.

Date approved: May 11, 1976 (IBRD)

POWER: The project provides for: (a) construction of electric power distribution facilities in the west Java and Jakarta areas, and (b) engineering consulting services.

Borrower: Republic of Indonesia, Perusahaan Umum Listrik Negara (PLN).

Loan: $90 million; 25 years including five years of grace at 8.5 percent interest per annum. Total project cost: $164.0 million.

Purpose and Benefits: Much of this project's benefits derives from the installation of appropriate facilities to distribute the increased power supply expected to be available by 1980, an increase in installed capacity from 445 MW in 1975 to 1,220 MW. The project justification is based on the economies that will result from having a reliable power supply as well as uniform voltage levels. Currently, in the Jakarta region, electricity services reaches only about one of every 44 persons and in west Java about one of every 87 persons. The existing voltage systems are completely overloaded. However, a total of 123,500 customers would be changed from 127 to 220 volt service; 140,100 new customers would be connected; and 222 connections would be provided to private substations of large customers. No ecological problems arise in connection with the project. In congested areas, the medium voltage system (20 KV) will be underground with transformers located in kiosks and the low voltage system (220/380 volts) generally overhead. In less congested areas, both systems will be overhead with the transformers mounted on poles.

Date approved: May 18, 1976 (IBRD)

AGRICULTURE: Major components of this project are: (a) tertiary development on 25,000 ha and on 75,000 ha being rehabilitated under previous IDA credits; (b) construction of a 6,000 ha new irrigation system in North Sadang, adjacent to the Sadang system and (c) detailed studies and designs on the Kedungombo storage dam in Central Java. In addition, the project would make provision for consultant services, studies, programs for local and overseas training for irrigation engineers, agriculturists and construction workers, and procurement of vehicles and equipment.

Borrower: Republic of Indonesia.

Loan: $33.0 million. The terms are for 25 years including six years of grace, with interest at 8.5 percent per annum. Total project cost: $60.0 million.

Purpose and Benefits: On project completion, the increase in paddy production is expected to total 130,000 tons annually. After deducting the incremental cost of imported fertilizers and chemicals, the annual net foreign exchange savings as a result of the project would be about $19 million at full development. The rate of return for North Sadang, which represents 21 percent of the project cost, is 20 percent. A substantial majority of the beneficiaries of the project would be small farmers and sharecroppers whose average income, even at full project development, would still be considerably less than the national average. The project would also benefit the landless labor force through increased yields as harvest wages are paid as a percentage of the crop. Since many landlords are also small operators farming their own fields, the project would also be beneficial to them.

Date approved: May 25, 1976 (IBRD)

AGRICULTURE: Through the strengthening of existing food crops extension services in nine Provinces, this project provides for: introduction of a sound extension methodology with emphasis on continuous training and regular farm visits; construction or renovation of 529 Rural Extension Centers (REC's); an increase in the number of extension staff; an extensive program of local training for extension workers along with a limited

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number of fellowships and overseas training tours; employment of a local firm of architects, an extension specialist, extension of IRRI rice research contract, and about 50 man-months of short-term specialists; and procurement of vehicles and equipment.

Borrower: Republic of Indonesia.

Loan: $22.0 million. The terms are for 25 years including six years of grace, at an interest rate of 8.5 percent per annum. Total project cost: $44.2 million.

Purpose and Benefits: Within the nine Provinces, the project will reach some 12.8 million farm families, cultivating about 7.3 million ha of paddy land and about 4.0 million ha of annual food crops. All farmers would benefit from direct or indirect contact with extension workers, who would convey the most practical and profitable advice for their crop production enterprise. In order to realize a 20 percent economic rate of return, the incremental net value of production, after completion of project construction, in year seven, would have to amount to $9.5 million per year which would require an increase in paddy yield of only 8 kg per ha over the 7.3 million ha of paddy land in the project provinces. Such an increase should be easily attainable in view of the relatively low existing yield levels and the large potential increment that is possible using present limited inputs and knowledge.

Date approved: May 25, 1976 (IBRD)

IRELAND

INTERMEDIATE CREDIT INSTITUTION: The loan will strengthen the Industrial Credit Company, Limited's (ICC) involvement in the promotion of regional development and employment. It will assist in the provision of credit to finance specific development projects in the industrial and distributive sectors (except retail outlets), in support of the country's policies to reduce regional imbalances and unemployment through industrial development. ICC plans to use the proceeds of the loan to finance projects outside Dublin County and 40 percent of the loan to finance small-scale enterprises.

Borrower: Industrial Credit Company, Limited (ICC).

Loan: $30 million, 15 years at 8.5 percent per annum.

Purpose and Benefits: In line with its policy of taking a more active role in industrial development, ICC expects to raise its share in fixed investments in the industrial sector to an annual average of 10 percent in 1976–78 and its estimated resource needs in the period February 1975–October 1978 total $215 million. ICC expects to obtain $128 million from Government loans, additional deposits and its own cash generation and $33 million from the European Investment Bank and the United Kingdom Export Credit Guarantee Department. The Bank loan would cover some 55 percent of ICC's potential resource gap for the period, and ICC is expected to make extensive efforts to raise the rest of the funds in international capital markets. The loan will assist ICC in achieving the objectives which it shares with the Government to promote a regional industrial development and small-scale private enterprises.

Date approved: August 19, 1975 (IBRD)

IVORY COAST

DEVELOPMENT FINANCE CO.: The loan funds will help Credit de la Cote d'Ivore (CCI) to meet the financial requirements of investments by small-scale enterprises (SSEs) in the Ivory Coast through 1978. The loan is expected to improve the efficiency of, and the cooperation between, CCI and the Office de Promotion de l'Entreprise Ivoirienne (OPEI), the country's principal public financing and technical assistance agencies, and more generally, to foster the Government's promotion program for indigenous SSEs.

Borrower: Ivory Coast, Credit de la Cote d'Ivore (CCI).

Loan: $5.6 million; 15 years at 8½ percent per annum.

Purpose and Benefits: The achievement of the objectives of the proposed project will offer substantial economic and social benefits to the Ivory Coast, including not only an adequate return on the investments of small indigenous enterprises but also opportunities for the development of local management capacity, the broadening of business ownership, and basic training of largely unskilled labor. In addition, the project will help support priority government policies and create employment, especially in urban areas where unemployment tends to be high, improve income distribution and achieve a more balanced regional development. It will also have important institution-building effects on the two principal public agencies of the promotion scheme, OPEI and CCI, and strengthen the latter's appraisal capacity. Financial rates of return for sub-projects in these already identified areas for subloans—woodworking, garages and balconies—are estimated to be 25 percent or more.

Date approved: August 21, 1975 (IBRD)

TRANSPORTATION: The loan funds will help finance the pavement strengthening of about 200 km of roads; realignment of a 27 km section of the Azaguie-Adzope road and construction of the Anyama-Agboville road (about 45 km); purchase of traffic counting, weight control and pavement survey equipment; technical assistance to establish a Planning and Research Unit, to improve training and to reorganize the Public Works Laboratory; and pre-investment studies for secondary and feeder roads in rural areas.

Borrower: The Republic of the Ivory Coast, Ministry of Public Works and Transport (MPWT).

Loan: $43.0 million; 20 years at 8½ percent. Total project cost: $55.6 million.

Purpose and Benefits: The success of the Government's program of economic diversification will depend largely on the availability of reliable and efficient transport. The Government also aims at achieving a more even distribution of income among various sectors of the population by spreading the benefits of development well beyond Abidjan. Road improvement and construction works will primarily result in cheaper, safer and more reliable transport and in savings in road maintenance costs. On the basis of conservative traffic projections, and not including benefits other than savings on transport and maintenance costs, the economic return on the pavement strengthening program is estimated at 15 percent with returns for individual sections ranging between 13 and 21 percent. The proposed realignment and construction of the Anyama-Agboville road and of the section of the Azaguie-Adzope road would yield economic returns of about 22 and 28 percent respectively. The overall economic return of the project roads is estimated at 19 percent. The project's technical assistance component will provide a start towards a major and much needed institution-building effort in sectoral management. It will ensure the eventual capability of the MPWT to evaluate and coordinate transport investment proposals and to formulate a firm sectoral policy.

Date approved: August 21, 1975 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: The overall objective of Banque Ivoirienne de Developpement Industrial (BIDI) is to encourage the development of private industrial enterprises and to promote the participation of foreign and domestic capital in the industrial development of the Ivory Coast. To this end, BIDI, which has been nearly the only domestic source of long-term financing for industry in the Ivory Coast, has progressively expanded its operations through the granting of long-term loans, investment in equity, and association with commercial banks through extending medium-term rediscountable loans. Its disbursements now represent about 10 percent of industrial investment in the Ivory Coast.

Borrower: Banque Ivoirienne de Developpement Industriel (BIDI).

Loan: $8 million, 15 years at 8.5 percent.

Purpose and Benefits: Since its inception in 1965, BIDI has played an important role in the sponsorship of local enterprises serving, principally, an import-substitution function. BIDI has been able to attract foreign private capital in its own right. Consistent with the changing thrust of industrial policy in the Ivory Coast, BIDI's future operations will now take more account of the need to consolidate past success by emphasizing the increasing importance of Ivorian ownership and management of enterprises. BIDI will also increase its efforts to sponsor export-oriented development. IBRD's involvement would strengthen BIDI's operational effectiveness in the areas of financial planning and control and in the evaluation of projects. In more quantitative terms, the proposed loan would enable BIDI to participate in investments totalling $75.0 million through 1977, creating over 5,000 new jobs. It is expected that BIDI will continue to earn an average return on its equity of 20 percent from 1977.

Date approved: November 18, 1975 (IBRD)

JAMAICA

POPULATION: The project will help to support the government's Maternal, Child Health/Family Planning and Nutrition (MCH/FP/Nutrition) programs by helping to finance: the construction and equipping of 57 health centers; technical assistance, fellowships, equipment, vehicles for training Community Health Aides (CHA's), midwives, medical officers, nurses and other staff in the MCH/FP Nutrition program; equipment for expanding postpartum family planning services to 17 remaining hospitals; equipment, technical assistance and vehicles for a mass communication/education program; technical assistance for a feasibility study for local production and processing of supplementary food, including training fellowships; technical assistance for a health facility maintenance system and a building utilization study; technical assistance, fellowships and equipment for demographic and research studies; technical assistance and fellowships to support the establishment of a Planning and Evaluation Unit (PEU) in the Ministry of Health and Environmental Control (MOHEC); and other innovative activities in the field of MCH/FP/Nutrition.

Borrower: Jamaica, Ministry of Health and Environmental Control (MOHEC).

Loan: $6.8 million; 25 years at 8.85 percent per annum. Total project cost: $13.2 million.

Purpose and Benefits: The project, which would account for about 40 percent of total estimated expenditures on the family planning program in Jamaica during the implementation period, should make a significant contribution towards achieving the target reductions of 22 percent in the gross reproduction rate and 21 percent in the general fertility rate during the period 1970 to 1980. The contribution of the project towards fertility decline would be the result of training, deployment and supervision of community workers, the extension of the hospital-based postpartum program, the promotion of breast feeding and sound nutritional practices and the associated increase in child survival. The results of evaluation and research would contribute to policy development, readjustment of program objectives and a more effective utilization of scarce resources. By reinforcing basic and in-service training, the project would improve the quality and number of community-based health workers. It is expected that an improvement in the nutritional status of children and pregnant and lactating mothers would induce a reduction in family size in the long run, thereby dampening the growth in population.

Date approved: June 8, 1976 (IBRD)

JORDAN

TOURISM: The project consists of: (a) tourist accommodation, related superstructure facilities and supporting infrastructure works near the Petra Entrance; (b) visitor facilities, infrastructure works and archaeological preservation in the Petra Basin; also the resettlement of about 96 Bedouin families currently living in the Basin; (c) visitor facilities (including a Sound and Light Program), infrastructure works and archaeological preservation at Jerash; (d) funds for a project unit and on the job overseas training for staff of the Antiquities Department of the Ministry of Tourism and Antiquities.

Borrower: Jordan, Ministry of Tourism and Antiquities (MTA).

Loan: $6.0 million; 50 years at 0.75 percent per annum. Total project cost: $12.1 million.

Purpose and Benefits: It is expected that the development of the tourist facilities at Petra and Jerash will begin to attract increasing numbers of visitors from 1979 on. With the project, visitors to Jerash are expected to increase by 15 percent annually over period 1975–85 and to Petra by 18 percent annually. Jerash, which is readily accessible from Amman for day trips is projected to receive 180,000 day visitors by 1980 and 337,000 by 1985, while Petra, located at a greater distance from Amman and therefore more limited in its appeal to short-stay visitors, is expected to receive 94,000 visitors in 1980 and 218,000 in 1985. On the basis of an estimated economic life of the project of 25 years, the economic rate of return would be 30.3 percent on investments of $6.8 million in Petra and 16.9 percent on investments of $2.1 million in Jerash yielding a combined rate of return of 20.1 percent on total project investments. The project is expected to increase annual net foreign exchange receipts by about $1.5 million in 1979 and by about $4.8 million from 1988 onwards. The Government, as the owner and the operator of most of the facilities to be built under the project, is expected to capture about 85 percent of the project's net benefits; while about 5 percent would go to the hotel and restaurant management company and the rest to souvenir sellers and shop owners. Direct employment generated by the project facilities would amount to 560 jobs while indirect employment in agriculture, handicrafts, trans-

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portation and other services is expected to account for an additional 600 jobs.

Date approved: June 8, 1976 (IDA)

INTERMEDIATE CREDIT INSTITUTION: These loan funds will help to meet part of the Industrial Development Bank of Jordan's (IDB) requirements for financing import components for the medium and small scale industrial and handicraft subsector.

Borrower: Jordan, Industrial Development Bank of Jordan (IDB).

Loan: $4.0 million, 50 years at 0.75 percent.

Purpose and Benefits: During the last Three Year Plan (1973–1975), it is estimated that projects financed by IDB accounted for 75 percent of private investment in medium scale industry. Although only 15 percent of IDB's loans were made to tourism projects during the Plan period, it is estimated that IDB was associated with 90 percent of all investment in this sector during the Plan period. The 28 industrial projects and 9 tourism projects assisted in 1974 accounted for the creation of 691 and 194 new jobs respectively. The average cost per job created was $26,700 for new projects and $22,100 for expansion projects, which is not excessive given the relative sophistication of Jordanian industrial sector. The economic impact of IDB's existing small-scale industry and handicraft program is difficult to measure at this early stage. However, it is expected to raise the skills, productivity and income level of small entrepreneurs. IDB's business prospects for the five years covered by its forecasts are good. Applications under study at the end of October 1975 involved a potential investment of some $24 million. This is substantial in relation to the Plan investment target for the entire Five Year Plan period of $106 million in medium and small scale industry. IDB expects to commit a total of $57 million over this period and to disburse a total of $52 million or about one-third of the Plan target.

Date approved: June 17, 1976 (IDA)

KENYA

POWER: The Gitaru hydroelectric project will be located between the existing Kamburu and Kindarum hydroelectric power stations. The three power stations will operate in cascade in that they will all use the same water, one following the other. Gitaru will complete the development of the hydro potential of the Upper Tana River referred to as the "Seven Forks" development. The project comprises: (a) a rock and earth-fill type diversion dam, with integral spillway, vertical intake shafts with short headrace tunnels to the underground power station; (b) an underground power station designed for three 67 MW generating sets driven by Francis turbines, with two sets installed under the project; the head is approximately 136 meters; (c) a partially lined trailrace tunnel about 4,700 m long emptying into the Kindaruma reservoir; (d) a 275 kV single circuit transmission line from Kamburu to just outside Nairobi (105 m). This line will operate initially at 132 kV; and (e) a management review and a study of the tariff structure.

Borrower: Tana River Development Company (TRDC).

Loan: $63 million; 25 years at 8.5 percent per annum. Total project cost: $135.9 million.

Purpose and Benefits: The cost analysis of several possible power development strategies is the next step involved in expanding Kenya's generating capacity. The East African Power and Lighting Company consultants conducted a detailed analysis and recommended that Gitaru power station be constructed for commissioning in 1978, to be followed by three gas turbines of 22 MW each for commissioning respectively in 1980, 1981 and 1982. The next best alternative will be the installation of three gas turbine units of 22 MW each in 1978, 1979 and 1980, respectively, with the commissioning of Gitaru postponed until 1981. A comparison between these two alternatives showed that the proposed strategy is preferable for all discount rates below 11.5 percent. The project would ensure that the demand for power in Kenya would be met by 1978 at the minimum cost. Since the equalizing discount rate of 11.5 percent is at the lower end of the opportunity cost of capital in Kenya (estimated at 11–13 percent) the choice of Gitaru project is a close one. It has been discussed extensively with the Government and the EAP&L, who strongly favor the Gitaru alternative because of uncertainties in obtaining dependable power from neighboring countries and in the cost of oil for thermal power, and because bilateral financing tied to this project is now available at reasonable terms. In view of the fact that this project is by a slight margin the preferred alternative and the estimated costs have been based on actual bids, the Gitaru project is the recommended alternative. The economic rate of return of the project is estimated to be 14 percent.

Date approved: July 1, 1975 (IBRD)

DEVELOPMENT FINANCE COMPANY: The loan funds will meet the Industrial Development Bank's (IDB) requirements for financing the foreign exchange component of large- and medium-scale industrial projects for the next 3 years.

Borrower: Industrial Development Bank (IDB)

Loan: $10.0 million, repayable in conformity with the aggregate of the amortization schedules for sub-loans.

Purpose and Benefits: This is the Bank's second loan to IDB which lends most of its resources to large and medium-sized industries in Kenya. It has assembled a competent staff and they have contributed to sub-projects by introducing more vigorous economic appraisal techniques for projects. IDB has also begun to undertake the role of a financial intermediary to mobilize additional local savings.

Date approved: July 8, 1975 (IBRD)

WATER SUPPLY: The project is the first phase of a two-phase program to extend and improve water supplies in the city of Mombasa and various locations in the coastal area of Kenya north of Mombasa. Specifically, the project comprises: (a) surface water abstraction facilities from the Sabaki River with a water treatment plant, pumping stations, some 190 km of transmission facilities, storage reservoirs, and distribution networks for four rural areas along the coast and Mombasa; (b) headquarters building for the Coast Province Water Branch (CPWB) in Mombasa and a telecommunications system required for the water supply operations; (c) engineering and management consulting services for CPWB; and (d) technical assistance to support the Water Department (WD) with an evaluation of existing rural water supply systems, preparation of future rural water supply systems and training of skilled manpower for WD.

Borrower: Republic of Kenya, Coast Province Water Branch (CPWB).

Loan: $35 million; 25 years at 8½ percent. Total project cost: $74 million.

Purpose and Benefits: The project is the least-cost method of satisfying the water needs of the region even though the estimated average cost per unit amount of extra water provided through this project is high, about Ksh. 23.0 per 1000 imperial gallons. Until recently average water charges in the project area were only Ksh. 7.0 per 1000 imperial gallons. Revenues from the sale of water have been projected assuming revised tariffs. Using these revenues as the sole measure of benefits from the water supplies, the internal economic rate of return of the project is estimated to be 11 percent. Other non-quantifiable benefits are improved health and sanitation, subsidized water supply to the poorer urban and rural consumers which have desirable income distribution effects, and the provision of safe and reliable water supply to Mombasa (the principal port in East Africa), to the tourist industry and other commercial and industrial activities which would otherwise be severely handicapped.

Date approved: October 7, 1975 (IBRD)

EDUCATION: The project comprises: (a) strengthening the Kenya Institute of Education; (b) improving educational broadcasting and multimedia services; (c) improving facilities at 17 primary teacher training colleges; (d) improving the efficiency of primary school equipment supply services; (e) helping to set up an Examinations Research and Development Unit in the Ministry of Education; and (f) providing technical assistance in specialized fields to support the work of NCEOP's secretariat and preparation of new projects.

Borrower: The Republic of Kenya, Ministry of Education.

Loan: $10 million; 25 years at 8.5 percent. Total project cost: $18 million.

Purpose and Benefits: The project is designed: (i) to improve the quality and efficiency of primary school education, particularly through the introduction of agricultural and other practical subjects and (ii) to encourage the review of longer term education policy by supporting the work of the National Committee on Education Objectives and Priorities (NCEOP). Primary school enrollments over the last four years have doubled to nearly three million, of which over one million children represent the increase from 1973 to 1974. This enrollment explosion has inevitably resulted in a significant lowering of standards particularly in the teaching force, unavoidably diluted by the emergency recruitment of many untrained teachers. The project has been designed as a well-integrated program to promote not only a general qualitative improvement, but more significantly a reorientation of basic education from its traditional role of preparing the few best pupils for entry to secondary schools, to one of providing a well-balanced education for pupils of varying ability to develop their talents for diverse employment opportunities including self-employment. The improved colleges would provide the necessary comprehensive facilities to provide teachers with instruction in the latest teaching techniques which would emphasize practical application to rural development. So that the schools would be equipped to provide the teachers with vital supporting material, the improved Primary School Equipment Services would ensure that relevant teaching materials are received by the schools, also these in remote areas, in a properly phased sequence. In statistical terms, the proposed project would provide facilities for in-service courses for about 6,000 primary teachers p.a., and thereby gradually reduce the number of unqualified teachers which was about 30,000 or 39 percent of the teaching force in 1974. By developing broadcasting and equipment services, nearly three million primary school children and 77,000 teachers in 8,000 schools would benefit.

Date approved: December 18, 1975 (IBRD)

KOREA

DEVELOPMENT FINANCE COMPANY: The fifth loan to the Korea Development Finance Corporation (KDFC) would be used to help cover the foreign exchange requirements of industrial subprojects to be financed through 1977.

Borrower: Korea Development Finance Corporation.

Loan: $55 million, 8.5 percent per annum. Amortization to conform to the aggregate of the amortization schedules applicable to the specific investment projects.

Purpose and Benefits: The Government's overall economic and industrial policies and, in particular, the increased emphasis on the development of the capital and intermediate goods industries, are appropriate for Korea's present situation. KDFC, whose performance to date has been very satisfactory from both the developmental and institutional points of view, is especially suited for providing finance and guidance in Korea. More than merely an efficient intermediary to channel Bank funds to economically and financially viable industrial projects, KDFC has made, and will continue to make, important contributions of its own toward improving both the resource allocation and resource mobilization systems in Korea. These contributions include notably KDFC's initiative in establishing other institutions, its role in promoting and assisting projects in the deep-sea fishing and marine transport sectors, and its present endeavor to launch a leasing company and to provide support in other ways for small- and medium-scale industries. The near-term strategy it is implementing should further broaden its developmental outlook and enhance its contribution to the Korean economy. For the future, KDFC's continued growth is not expected to be constrained by a lack of demand for the financing and other services it offers. Besides the main objective of providing resources for the further expansion of the industrial sector, the proposed loan would help to relieve pressure on Korea's balance of payments. The World Bank has been able, after having helped to establish a strong and efficient institution, to continue to exert its influence on KDFC to sustain and improve its operational standards, to be innovative in its financing approach, to put emphasis on the economic merits of projects seeking its assistance, and more generally to commit itself to broader developmental objectives.

Date approved: July 15, 1975 (IBRD)

AGRICULTURE: The project consists of: (a) the establishment of about 450 new dairy farms, each initially with eight heifers; (b) the continuation of the development begun earlier on about 400 dairy farms by increasing the numbers of heifers on each farm; (c) the expansion of existing processing plants; (i) which produce baby milk-powder, sterilized fluid milk, and whole milk powders; (ii) the diversification of present plants to include the production of butterfat, evaporated milk, and powdered coffee creamer; (iii) the establishment of two milk collection centers; (iv) provision of approximately 50 small milk cooling units; and (v) construction of a frozen milk products plant at Yeongnam; and (d) expansion of technical services for both farm development and milk processing.

Borrower: The Republic of Korea, National Agricultural Cooperative Federation (NACF).

KOREA—Continued

Loan: $15.0 million; 25 years at 8.5 percent per annum. Total project cost: $24.5 million.

Purpose and Benefits: The project would directly benefit 850 farm households with a population of 4,250 and would develop about 4,600 ha of unutilized land and 2,000 ha of partially developed land. On-farm employment would be created for 800–1000 permanent workers and about 3,500 casual laborers. The economic rate of return, after an adjustment to border prices, is estimated to be 15 percent. In addition, the project at full capacity would supply 5,470 mt of sterilized milk at Honam with a market value, in constant prices, of $2.8 million. The central plant would produce an additional 1,834 mt of baby powdered milk marketable for about $5.1 million and 466 mt of powdered coffee creamer marketable at about $1.9 million. The Yeongnam plant would produce 11,000 mt of frozen milk products with a value of $17.7 million. The rates of return on the processing component of the project are expected to be high. The expansion of the central plant would have a rate of return of 37 percent, the Honam expansion 31 percent, and the installation of the Yeongnam plant 37 percent.

Date approved: October 28, 1975 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: The loan would be used to help cover the foreign exchange requirements of industrial sub-projects to be financed by the Medium Industry Bank (MIB), Korea's most important source of term finance and technical assistance to small and medium-sized industries.

Borrower: Medium Industry Bank (MIB).

Loan: $30.0 million. Amortization to conform substantially to the aggregate of the amortization schedules applicable to the specific investment projects financed out of the proceeds of the proposed loan.

Purpose and Benefits: MIB plans to increase its lending in areas outside the Leone/Pusan industrial complex, thereby contributing to a more equitable regional distribution of jobs and income. An analysis of the available data on 174 projects for which MIB approved foreign currency loans in the two-year period 1973–74 indicates that these projects have generated a total investment of $70 million equivalent. Annual incremental sales attributable to these projects are estimated to average $144 million equivalent of which 49 percent ($79.8 million) is expected to be exported. The direct additional employment generated by these projects was 22,369, at an average investment cost of $3,800 equivalent compared with a national average investment cost of $5,500 per employee for Korean industry as a whole.

Date approved: November 18, 1975 (IBRD)

TRANSPORTATION: This project consists of: (a) construction, chiefly on new alignments, including paving, of about 195 km of four national highways totalling about 600 km, including supervision of the work by consultants; (b) paving and improvement, chiefly on present alignments, of nine national highways totalling about 600 km, including supervision of the work by consultants; and (c) feasibility studies by consultants of about 1,200 km of national and provincial roads, to be followed by detailed engineering if found justified.

Borrower: The Republic of Korea.

Loan: $90.0 million, total project cost is $220.7 million, 24 years at 8.5 percent per annum.

Purpose and Benefits: The objective of the project is to assist in improving the highway system to cope with the growing traffic by extending the network of all-weather paved highways between the main centers of population by nearly 800 km, and, through studies and engineering, prepare future projects for improving the network. The project will also help to reduce the high costs of moving goods and people and provide easier access to some isolated areas with high economic development potential. The economic rates of return for the roads to be constructed, (calculated over an assumed 20 years service life of the investment) vary between 21 percent and 37 percent. Insofar as the paving program is concerned, the economic rate of return ranges between 15 percent and 37 percent. The weighted average rate of return for construction is 31 percent, and for paving is 37 percent. The combined weighted average rate of return for construction and paving is 29 percent.

Date approved: February 10, 1976 (IBRD)

AGRICULTURE: This project consists of: (a) the construction of 66 minor irrigation sub-projects which will provide irrigation facilities for tracts of land ranging from 50 to 700 ha in size; (b) upland reclamation of roughly 4,500 ha involving some 35 sub-projects; (c) the development of about 11,000 blocks of fuelwood plantations over an area of approximately 127,000 ha; (d) the construction of a total of 850 km of village roads and 200 bridges; (e) the construction of simple water supply systems for some 2,000 villages; (f) the electrification of about 300,000 rural households through a program involving some 2,700 sub-projects and (g) the improvement of hydrological services.

Borrower: The Republic of Korea, Ministry of Agriculture and Fisheries.

Loan: $60.0 million; $20 million at 8.5 percent for 25 years and $40 million at 4.5 percent for 25 years. Total project cost: $143.5 million.

Purpose and Benefits: The project would benefit about four million (30 percent) of Korea's rural population, which, on the whole have incomes considerably below the national average. The benefits would result from the intensification of agricultural production, opening up of new farmland, expansion of fuelwood production, reductions in transport costs and an improvement in the quality of rural life. The number of beneficiaries is unusually high because there would be little overlap between the sub-projects of the various components. The project would also encourage decentralized decision-making, help to develop village-level institutions, and be a further step in the Government's efforts to narrow inequalities between the urban and rural sectors, as well as within the rural sector. Another impact of the project would be an increase in employment; project construction would require about 13.8 million man-days of unskilled village labor, which would reduce unemployment in the off-season, and permanent employment would be provided for about 3,900 persons on a full-time basis directly as a result of the agricultural components. The project will include over 15,000 sub-projects scattered throughout Korea and there would be little interaction between the various components; it is on this account that the rate of return for each component has been analyzed separately. Using a seasonal shadow price for labor, the economic rate of return would be about 13 percent for irrigation, 21 percent for upland reclamation, 19 percent for fuelwood, and 10 percent for rural electrification. For roads and bridges, the rate of return would be at least 8 percent for each sub-project (exclusive of non-agricultural and welfare benefits which on the basis of the rate of return on a selected sample of road is expected to amount to a minimum of 3 percent). Water supply is justified mainly as a contribution to the qualify of rural life. The fact that the villagers would contribute about 35 percent of the capital cost in the form of voluntary labor, as well as all operation and maintenance costs, is an indication of the high value they place on this service.

Date approved: March 9, 1976 (IBRD)

PROGRAM LOAN: The loan funds will help to meet the foreign exchange requirements for imports into the Republic of Korea by the private sector of essential capital and intermediate goods.

Borrower: Republic of Korea.

Loan: $75 million; 20 years at 8.5 percent per annum.

Purpose and Benefits: Korea has suffered balance of payments losses in 1974 and 1975 due to an exceptional combination of adverse events. The average loss in the two years on account of terms of trade movements alone is estimated at about 7 percent of GNP (at 1970 prices and exchange rates). Any attempt to adjust to such a large foreign exchange loss without incurring sizeable balance of payments deficits would undoubtedly lead to large-scale unemployment and a loss of growth momentum, which would have severe adverse consequences for Korea's long-term economic development. The essence of Korean policy, therefore, has been to smooth the process of adjustment, while at the same time attempting to ensure that there is a steady movement toward long-term improvement in the balance of payments. Toward this end, the Korean Government has intensified measures by which it had already begun, earlier in the decade, to tackle longer term structural problems in its balance of payments and the need to increase the availability of resources for investment.

Date approved: March 9, 1976 (IBRD)

LESOTHO

TRANSPORTATION: This project consists of: (a) the improvement of the existing St. Michaels-Mantsonyane 95 km gravel road and the reconstruction of the existing 52 km earth track between Mantsonyane and Thaba Tseka; (b) consulting services to revise the construction documents and supervise the road construction; (c) the establishment of road maintenance facilities along the project road including maintenance equipment, storage facilities, a workshop, offices and staff housing; (d) the organization and three year operation of a labor-intensive construction unit to develop procedures and systems for carrying out labor-intensive construction works; and (e) ten man-years of technical assistance for increasing the operational capacity of the Ministry of Works and two man-years of technical assistance for the Labor Commissioner's office to provide expert advice on developing an employment monitoring capability in Lesotho.

Borrower: The Kingdom of Lesotho, Ministry of Works.

Loan: $5.5 million; 50 years at 0.75 percent per annum. Total project cost: $8.6 million.

Purpose and Benefits: Benefits from the road improvement/reconstruction would accrue largely to the 56,000 people living in the immediate area of the road's influence in the form of savings from reduced transport costs and increased net value of agricultural production. Reconstructing the Mantsonyane-Thaba Tseka road is justified as part of a total regional development package. Thaba Tseka has just been named the headquarters of Lesotho's Tenth District. It is also the center of a $8.0 million Mountain Area Rural Development Project. The Mountain Area Project aims at increasing crop and livestock production and improving living conditions through infrastructure investments. The improved road should enable farmers to improve livestock production and to switch from subsistence maize production to wheat, for which conditions are much more suitable. A major unquantified benefit is the increased access that the people in the remote Thaba Tseka region and the mountain areas would have to Maseru, the nation's capital, and the social services available in the more developed lowlands. The rate of return, assuming a 15 year economic life, is 13 percent for the St. Michaels-Mantsonyane section and 11 percent for the Mantsonyane-Thaba Tseka section (calculated in conjunction with the Mountain Area Development Project and assuming Phase 2 begins in 1980).

Date approved: March 2, 1976 (IDA)

LIBERIA

POWER: The project would be carried out over a three-year period and consists of: (a) about 18 man-years of planning experts for establishing a long-range development plan and a detailed investment program, and (b) about 25 man-years of internationally recruited experts for strengthening Liberia Electricity Corporation's (LEC) management and for training LEC's staff.

Borrower: Liberia Electricity Corporation.

Loan: $1.8 million; 20 years at 8½ percent per annum. Total project cost: $26 million.

Purpose and Benefits: The planning personnel and the consultants would prepare an urgently needed power development plan which would identify the least-cost solution for meeting Liberia's future power requirements. The development plan would cover the whole country and address the problems of meeting the power requirements of isolated mining areas. This is likely to lead to an integrated development of the power sector with substantial benefits to Liberia, in the long-run, in the form of reduced imports of fuel. Since part of the planning would be carried out by experts employed directly by LEC, a permanent planning unit would be established within LEC, and LEC's own staff would increase its planning skills to reduce reliance on outside consultants in the future. With the management assistance program and the associated training efforts, the objectives expected to be achieved are: (i) over the short-term—a halt in the deterioration of LEC's services, and the laying of foundations for an improvement in its operations, in particular, equipment utilization and maintenance, personnel productivity, customer service, billing, and collection; (ii) over the longer-term—the reestablishment of an efficient power utility having satisfactory operational and financial controls in addition to planning which would enable it to offer the most economic electric energy to potential users in the country.

Date approved: July 8, 1975 (IBRD)

AGRICULTURE: The project will be carried out over a five-year investment period, 1976–80 and will (a) assist 8,000 small farmers to improve and/or develop 5,600 hectares of upland rice, 1,900 hectares of rainfed and irrigated swamp rice, 2,800 ha of coffee and 2,300 ha of cocoa; (b) strengthen agricultural support services; (c) establish farm input delivery systems through existing

LIBERIA—Continued

cooperatives; (d) strengthen the institutional framework for agriculture development; and (e) improve existing infrastructure.

Borrower: Republic of Liberia.

Loan: $6.0 million; 50 years at 0.75 percent per annum. Total project cost: $17.0 million.

Purpose and Benefits: The project has two major objectives: (a) to raise the income and improve the quality of life of some 8,000 of the poorest farm families in Liberia (each with average holdings of less than 4 ha) through improved cultivation practices, better transportation, provision of reliable water supplies and disease control, and (b) to help establish sound, reliable institutional and technical support agencies for implementing this and future projects for smallholders. The risks involved in such a project are not inconsiderable. The project site is in a relatively remote section of the country. The intended beneficiaries typically work by traditional methods, barely participate in the market economy, live in poor social conditions and subsist on a modicum of food production from their farms. The risks are worth taking, however, since the Government of Liberia is now firmly committed to smallholder development and seems willing to consider bold, innovative measures to help achieve that objective. The economic rate of return is estimated to be 26 percent. At project maturity in 1987, incremental annual production would amount to 7,300 tons of milled rice, 2,500 tons of coffee and 1,600 tons of cocoa with a total foreign exchange benefit of $9.3 million. The average net farm family income is estimated to increase from the present $313 to $913 at project maturity. Apart from these direct benefits to participating farmers, the project would have important secondary benefits, largely unquantifiable, for the community as a whole from improved roads, banking, education and health facilities, including improved drinking water supplies. The project would also strengthen the Agriculture Ministry's technical capabilities, its cooperative/credit extension, agricultural research, and project management for future development activities.

Date approved: July 22, 1975 (IDA)

TRANSPORTATION: The project includes the following components: (a) construction of a two-lane bridge (1,400 feet) across the Mesurado River in Monrovia: (b) upgrading the United Nations Drive (5.4 miles) in Monrovia; (c) construction and realignment of the Totota-Ganta road (83 miles); (d) a three-year program for construction and improvement of about 150 miles of feeder roads; (e) technical assistance to Ministry of Public Works (MPW) Planning Division; and (f) consulting services for: (i) construction supervision; (ii) feasibility studies for improvement of the roads Ganta-Tpoeta (65 miles) and Ganta-Sanniquellie (25 miles); (iii) detailed engineering for the Mount Coffee Dam road (15 miles); and (iv) a study of Monrovia's urban development and transport system.

Borrower: Republic of Liberia, Ministry of Public Works (MPW).

Loan: $27.5 million; 25 years at 8½ percent per annum. Total project cost: $46.7 million.

Purpose and Benefits: The project will improve the transport infrastructure of Liberia, presently a major constraint to the development of the country outside the foreign enclaves. The road construction component will provide or improve key sections of the rural transport system and, in the process, open up the agricultural heartland of the country where the average income of the beneficiaries is now about $70 per annum, or about one-fourth of the national average, as well as improving access to the port of Monrovia, making a significant contribution to efficient commerce. The technical assistance element to the MPW will help consolidate the institution building effort in sectoral management and highway planning started under the Second Highway Project. The urban study of Monrovia will help establish the framework for an efficient transport and land use program for the capital city. On the basis of the quantifiable benefits—namely reduced maintenance costs of roads, reduced vehicle operating costs, time saving of users, improved clearance of the port area—the investments are expected to yield an overall economic return of 23 percent.

Date approved: August 21, 1975 (IBRD)

EDUCATION: This project comprises: (a) assistance to the community schools program by providing for: (i) construction, furnishing and equipping of 100 primary school units in about 50 villages and the expansion and improvement of a rural teacher training institute; (ii) technical assistance for primary teacher training administration of adult education and program evaluation. (b) Strengthening of the Ministry of Education by providing for: (i) minor works for preparing a building for textbooks production; (ii) technical assistance, equipment and supplies to effect administrative reform, and improve curriculum development. (c) Technical assistance for preparation of future projects.

Loan: $4.0 million; 25 years at 4.5 percent per annum. Total project cost: $5.4 million.

Borrower: Republic of Liberia, Ministry of Education.

Purpose and Benefits: This second education project will promote a closer link between the education system and the country's economic development objectives. It would assist the Government in: (a) making basic education accessible to rural children and adults; (b) increasing the output and improving the quality of trained teachers to serve in rural schools; and (c) training and giving experience to a corps of Liberians to administer the education sector. The project would also assist the Government in correcting the traditional geographical imbalance in the distribution of school facilities; the primary community schools to be assisted under the project would be located in north-western Liberia. It would help improve and strengthen the Government's administrative and planning machinery for the achievement of the country's longer-term educational and training objectives.

Date approved: May 25, 1976 (IBRD)

MADAGASCAR

TRANSPORTATION: This project consists of: (a) reconstruction of a 67 km two-lane paved road between Arivonimamo and Analavory Road No. 1 (RN1); (b) construction to gravel standards of a 370 km secondary road between Tsiroanomandidy and Maintirano; (c) provision of consulting services for engineering and supervision of construction of the Tsiroanomandidy-Maintirano road; (d) purchase of maintenance equipment, spare parts, weigh bridges, portable scale and vehicles, following a study to determine requirements; and (e) training of the staff of the Ministry of Public Works, following a study to determine requirements.

Borrower: Democratic Republic of Madagascar; Ministry of Public Works (MTP).

Loan: $22.0 million; 50 years including 10 years grace at 0.75 percent per annum. Total project cost: $31.8 million.

Purpose and Benefits: Both all weather project roads would provide a direct connection between Tananarive and the western part of the country. Reconstruction of RN1 the cost of which, including contingencies, is $10.0 million, will result in savings through reduced transport costs, and its economic rate of return is estimated to be 13 percent. The Tsironanomandidy-Maintirano road will open up an area with substantial agricultural potential. The justification for this road is thus primarily a developmental one, and the benefits will depend to a large extent on the implementation of the Village Livestock project, which is presently encountering some problems. However, this situation should improve and the benefits should be passed on to the farmers, since the highly competitive structure of the transport industry will exert pressure to reduce tariffs. The rate of return for this road, the cost of which is $12.5 million, is estimated to be 12 percent. The project components for training and road maintenance will result in improved work organization, increased efficiency in operating and maintaining equipment, improved road maintenance procedures and improved capability to enforce axleload regulations.

Date approved: June 15, 1976 (IDA)

MALAWI

EDUCATION: The project is that part of the Government's investment program for the education sector for 1975–1980 for which the Government does not expect to be able to obtain financial assistance from other sources. The project consists of the following parts: (a) the construction, furnishing and equipping of: (i) 22 new prototype primary schools which will serve as models to be replicated by local communities; (ii) 22 new rural education centers; (iii) one new teacher training college including a demonstration school, boarding facilities and staff houses; and (iv) additions to seven secondary schools including boarding facilities and staff houses; and (b) a program to prepare future educational projects in Malawi.

Borrower: Republic of Malawi, Ministry of Education.

Loan: $11.6 million; 50 years at 0.75 percent. Total project cost: $15 million.

Purpose and Benefits: The proposed project would provide facilities to expand and strengthen on-going educational development programs and would help meet the rapidly increasing demand for qualified primary school teachers. It would extend the teaching of practical and commercial subjects to more primary and commercial schools. In addition, the project would reduce socio-economic disparities by increasing the enrollment of girls in secondary schools, assisting the promotion of secondary education in rural areas and, through the Rural Education Centers, by teaching rural adults the basic skills they require for productive self-employment.

Date approved: November 11, 1975 (IDA)

RURAL DEVELOPMENT: The project consists of the provision of seasonal and medium-term credit to farmers, extension services, market complexes, health facilities, boreholes and other infrastructural facilities, agricultural and hydrological research, preparatory investments for the National Rural Development Program, and rehabilitation of berthing facilities at Chipoka Lake terminal.

Borrower: Malawi, Ministry of Agriculture and Natural Resources (MANR) and Karonga Rural Development Program (KRDP).

Loan: $9.2 million; 25 years at 4.85 percent per annum. Total project cost: $12.1 million.

Purpose and Benefits: This loan continues support for the government's rural development program designed to raise agricultural productivity nationwide. An estimated 10,000 additional farmers whose present per capita incomes are at the absolute poverty level of $40 would, as a result of the project investments, be able to increase their annual earnings from crop production by an average of $45 depending on the type and size of their farms. A much larger number of farm families would benefit from the project's investments on health and water facilities and the construction of rural roads. The project would also provide temporary additional employment for about 1,000 people. The construction of berthing facilities and associated structures at Chipoka would increase the capacity of the port, decrease ship turnaround time, increase the productivity of cargo handling and reduce cargo damage.

Date aproved: June 15, 1976 (IBRD)

MALAYSIA

POWER: The project consists of the following: (a) construction of the final extension of the Prai Thermal Power Station comprising three units of 120 MW each, scheduled for service in August 1979, February 1980 and August 1980, respectively; (b) installation of a 132 KV transmission line from Majadee switching station to Kota Tinggi, scheduled for service in 1978; (c) extension of 11 KV distribution system to two rural areas, scheduled for service in 1978; and (d) consulting services for a rural electrification study and other services.

Borrower: National Electricity Board (NEB).

Loan: $35 million; 20 years at 8.5 percent per annum. Total project cost: $71.3 million.

Purpose and Benefits: Consultants' studies of NEB's system expansion program have demonstrated that the sequence of projects as proposed is the least cost solution to meet the load requirement up to 1983. It includes the Temengor Hydroelectric Development, the Prai Thermal Power Station extension, and the associated transmission and distribution sub-projects. The economic justification of the two distribution sub-projects has been demonstrated by a comparative study of the diesel alternatives. These projects are less costly than diesel for discount rates up to 13 and 15 percent respectively. The internal rate of return of the Prai Thermal Power Plant extension is approximately 11 percent.

Date approved: December 2, 1975 (IBRD)

SEWERAGE PROJECT: This project consists of: (i) about 52 miles of lateral sewers varying in size from 9 to 15 inches; (ii) about 16 miles of trunk sewers ranging in size from 15 to 60 inches; (iii) improvements to an existing sewage treatment plant; (iv) construction of four new pumping stations; (v) construction of three new sewage treatment facilities; and (vi) consulting services.

Borrower: Malaysia, the City of Kuala Lumpur.

Loan: $21.5 million; 21 years at 8.5 percent per annum. Total project cost: $60.5 million.

Purpose and Benefits: The population of Kuala Lumpur, currently 780,000, is growing at a rate of 3.7 percent annually compared with the national growth rate of 2.7 percent. Water consumption and liquid waste production are increasing at about double the population rate.

MALAYSIA—Continued

Water production capacity for the Kuala Lumpur region is being enlarged under two Bank-financed water supply projects to meet water supply needs through 1981. However, the volume of liquid waste in the areas to be served under the project has reached levels which are clearly beyond the handling capacity of rudimentary septic tank or night soil systems. The project is a logical continuation of the sewerage construction program undertaken by the City and financed by the Government since 1953. As a result of the project, the population provided with sewerage service would double from about 200,000 in 1975 to 400,000 in 1981 and the percentage of the whole population of the Federal Territory receiving sewerage service would increase from the present 25 percent to about 45 percent in 1981.

This project represents the least cost piped sewage collection and disposal system for the areas to be served, and would (i) maximize the use of the existing sewerage system; (ii) reduce dependency upon night soil collection and septic tanks in developed areas; (iii) eliminate the need for owner constructed septic tanks and other disposal methods in areas presently under development; and (iv) help stabilize the level of pollution in receiving water-courses through simple, effective sewage treatment processes. Measurable benefits of sewerage projects are difficult to quantify; nevertheless, it is known that the project will effect cost savings in terms of (i) reduced expenditures for construction and maintenance of septic tanks and for night soil collection; and (ii) reduced medical costs and reduced loss of income due to sickness related to poor sanitary facilities. Furthermore, the impact on aesthetics and consumer convenience is far superior to the alternative of septic tanks.

Date approved: February 24, 1976 (IBRD)

URBAN TRANSPORT: The project will consist of: new roads and road improvements; traffic engineering and control; sites and services; and technical assistance and training.

Borrower: Government of Malaysia, City of Kuala Lumpur, and the Urban Development Authority.

Loan: $26 million; 25 years at 8.5 percent per annum. Total project cost: $72 million.

Purpose and Benefits: This project will (i) increase the efficiency of the transport system in Kuala Lumpur; and (ii) develop low cost urban settlements, thus contributing to the resettlement of squatters being displaced through various urban development projects. The transport component accounts for 76 percent and the sites and services component for 10 percent of total project cost; technical assistance accounts for the remaining 14 percent. The economic rate of return of the project as a whole is estimated at about 30 percent; 31 percent for the transport component, the benefits of which are assumed to consist of savings in vehicle operating cost and user time, and 23 percent for the sites and services and squatter area upgrading components, the benefits of which are assumed to consist of rentals and increased land values.

Date approved: February 24, 1976 (IBRD)

AGRICULTURE: The basic components of this project are: (a) Construction in the Lemal area of major flood control and drainage works to serve 30,000 ha; tertiary and quaternary irrigation and drainage networks and access roads to serve 12,000 net ha; and maintenance equipment. (b) Construction of about 15 small irrigation schemes to serve about 1,300 ha. (c) Construction of about 190 km of roads outside the Lemal area and provision of maintenance equipment and facilities. (d) Provisions of facilities, equipment, and service for agricultural extension field staff. (e) Construction and expansion of 25 new Farmers Development Centers and provision of equipment and storage facilities. (f) Studies of the feasibility of improving the existing State land development schemes and of glass-reinforced polyester flume irrigation conduits.

Borrower: Malaysia, Public Works Dept.

Loan: $21.0 million; 23 years at 8.85 percent. Total project cost: $48.0 million.

Purpose and Benefits: The project will improve the productivity and incomes of low income smallholders throughout the North Kelantan region by providing the irrigation and road facilities and supporting services required to raise agricultural yields, production, and farm incomes throughout the North Kelantan region. The project would yield high economic returns. Individual rates of return have been calculated for the Lemal irrigation, small-scale irrigation, and road components.

Date approved: June 24, 1976 (IBRD)

MALI

TRANSPORTATION: The project will consist of: (a) a three and a half year continuation of the feeder road improvement program initiated under the First Highway Project (about 12,000 km should be completed); (b) a three year maintenance program (i) to eliminate the backlog on periodic maintenance on paved roads; (ii) to procure spare parts and (iii) to equip the workshops of two new subdivisions; (c) procurement of office equipment, teaching materials and vehicles for the Department of Public Works (DPW) Training Center at Bamako; and (d) consultant services for: (i) technical assistance to DPW for feeder road improvement, road maintenance, and staff training; and (ii) a study of a country-wide transport plan.

Borrower: The Republic of Mali, Department of Public Works (DPW).

Loan: $10.0 million; 50 years at 0.75 percent. Total project cost: $13.4 million.

Purpose and Benefits: Benefits of the feeder road and maintenance elements of the proposed project will be realized in lower vehicle operating costs and increased agricultural production, and overall improved efficiency of the road transport industry. Further, all works will be executed by DPW which will use this opportunity to strengthen the organizational structure built up under the previous projects financed by IDA. The economic return on the feeder road component of the project is estimated to be 17 percent; even with an increase in all costs or a reduction of benefits of 25 percent, the return is still 10 percent. Finally, the backlog of maintenance included in the project has a benefit/cost ratio of more than 3 using a discount rate of 12 percent.

Date approved: December 11, 1975 (IDA)

MAURITANIA

TRANSPORTATION: The project includes: civil works for: extension of the fishing berths by 300 m, extension of the commercial berths by 48 m; reconstruction and widening of the approachway linking the berths to the shore, and extension of one of the ramps for fishing craft, construction of a sewerage scheme, and construction of administrative and other buildings.

Borrower: Islamic Republic of Mauritania, Port Autonomome de Nouadhibou (PAN).

Loan: $8 million; 50 years at 0.75 percent per annum. Total project cost: $27.6 million.

Purpose and Benefits: The loan funds are: (a) to help provide additional capacity at Nouadhibou port, and (b) to assist the Port Autonome de Nouadhibou (PAN) to improve its administration, organization, and operations. The project as a whole is expected to yield an economic rate of return of about 26 percent for Mauritania over a 25 year period. The fishing berths will provide a rate of return of 30 percent which reflects: (a) increased landings of fish due to the increased berthing capacity which would enable Mauritania to take advantage of existing and proposed landing agreements with major foreign fishing fleets, (b) greater revenue from fish products in the form of taxes and benefits retained in Mauritania due to an expected increase in productivity in and expansion of the fish processing plants, and (c) employment opportunities for the local population both on foreign vessels as well as in the fishing plants. Extension of the commercial berths and rehabilitation of the approachway are expected to yield an 18 percent rate of return. Benefits accruing from the additional berths (including the approachway) consist mostly of the reduction in ship waiting time, lower costs for stevedoring and shore handling, and savings on loss and damage as a result of decreased lighterage.

Date approved: October 28, 1975 (IDA)

MAURITIUS

DEVELOPMENT FINANCE COMPANY: The loan funds will help continue efforts initiated by earlier loans for financing direct investments and sub-loans by the Development Bank of Mauritius (DBM) for industrial and tourism development projects. DBM was established in 1964 to finance the development of industry and tourism as well as the diversification of agriculture.

Borrower: Development Bank of Mauritius (DBM).

Loan: $7.5 million; 20 years at 10 percent for tourism and 15 years at 10 percent for all other loans.

Purpose and Benefits: The industrial sector is still dominated by sugar processing and, until recently, most of the non-sugar manufacturing output came from industries catering to the domestic market. Because of the small size of the domestic market, however, import substitution has only limited potential and most of the possibilities are already exhausted. The major scope for industrialization now lies in the transformation of imported raw materials and intermediate products for export markets. The dexterity and high quality of the Mauritius labor force and its low cost compared with competing countries is a considerable asset, particularly for industries where labor cost is a large share in value added. Mauritius also has distinct attractions for tourism such as unspoiled white sand beaches, coral reefs, lagoons and subtropical temperatures with long daily periods of sunshine on the coast. DBM will assist efforts to establish export-oriented, labor-intensive small and medium scale industries and tourism by providing capital to create new production and jobs.

Date approved: October 21, 1975 (IBRD)

MEXICO

WATER SUPPLY AND SEWERAGE: The loan funds will be used for the improvement and extension of water supply facilities in eight medium size cities (Ciudad Victoria, Jalapa, Mexicali, Morelia, Reynosa, Salamanca, Tampico-Ciudad Madero and Tuxtla Gutierrez) and sewerage services in six of these. The project also includes a training program for the executing agency, the Ministry of Hydraulic Resources (SRH), and the beneficiaries' staff.

Borrower: Banco Nacional de Obras y Servicios Publicos (BNOSP).

Loan: $40 million; 20 years at 8.5 percent per annum. Total project cost: $100.0 million.

Purpose and Benefits: The most important aspect of the project is the proposed introduction of major changes in the investment and financial policies of the municipal water and sewerage authorities and the provision of a basis for institutional reform in the water supply and sewerage sector. It is expected that the sector investment fund will become in the future one of the main sources of financing and agent of sector reform, which will help in generating resources for further investment and in fostering the introduction of financial discipline in the water supply and sewerage system. Finally, the establishment of the project unit in SRH could provide the core around which to build an organizational reform of the sector at the national level. From a social point of view, the project will be basically oriented towards the periphery of the cities, which are at present unserved; this will largely benefit the lower income groups whose access to water supply is at present limited. Improved water supply and sewerage services will help control water-borne diseases and, over time, beneficially affect the productivity and incomes of the poor. The systems will be so designed that the services can be provided at costs these people could afford to pay.

Date approved: December 18, 1975 (IBRD)

INTERMEDIATE FINANCE COMPANY: These loan funds will help the Industrial Equipment Fund (FONEI) provide for foreign exchange financing for fixed assets of specific export-oriented and efficient import-substitution projects with potential to export.

Borrower: Nacional Financiera, S.A., Fondo de Equipamiento Industrial (FONEI).

Loan: $50 million, 16 years at 8.5 percent per annum.

Purpose and Benefits: The loan will contribute to improving Mexico's balance of payments by helping finance projects with export potential that might otherwise not be undertaken due to scarcity of long-term financing. Individual projects will have to show acceptable economic rates of return, in addition to meeting sound technical and financial criteria. The loan will also complement the recent series of fiscal measures adopted by the Government for the promotion of manufactured exports, and will support efforts towards more flexible interest rate policies which are conducive to efficient resource mobilization efforts. Additionally, the project will be instrumental in fostering significant institutional development by inducing participating intermediaries to move towards financing projects on the basis of project appraisals, thus providing credit to borrowers who have sound projects but who lack sufficient collateral to satisfy other guarantee requirements.

Date approved: February 3, 1976 (IBRD)

LIVESTOCK CREDIT: The project consists of (i) a low-income producers sub-project (LIPS) tailored to the needs of the traditional small farmers; (ii) a medium-income producers' sub-project (MIPS); (iii) an agro-industries sub-project for groups of agricultural producers, MEXICO—Continued

predominantly *ejidatarios* and small farmers; and (iv) a program of applied research, training and monitoring.

Borrower: Nacional Financiera, S.A. (NAFIN), Fondo de Garantia y Fomento para la Agricultura, Ganaderia y Avicultura (FONDO).

Loan: $125.0 million; 20 years at 8.5 percent per annum. Total project cost: $413.3 million.

Purpose and Benefits: This project would partly meet the demand for agricultural investment credit which will emerge from the expanded public investment and service programs in agriculture, the incentives provided by the government's price support policies, and the expected improvement in the absorptive capacity of the reorganized public agricultural system. The economic rate of return of on-farm investment (low and medium-income producers subprojects accounting for 77.4 percent of the loan) is estimated at about 27 percent, depending on distribution of funds among different investment activities which are calculated to yield between 20 and 36 percent according to representative farm models. The agroindustries subproject (15.4 percent of the loan) has an estimated economic rate of return of about 30 percent with a range of 16 percent to 42 percent. While the outlays for applied research, training and monitoring will also have a highly beneficial impact, a quantification has not been attempted.

The thrust of the project is on increased production. The additional production of basic foodgrains and milk would help meet the rising demand of Mexico's growing population and save foreign exchange through import substitution while increased production of live cattle, fruits, etc, should help add to foreign exchange receipts. Consistent with the general production objective, the project would focus on raising productivity and hence incomes of small farmers. Family income after full development is expected to more than double in all cases, except for dual purpose cattle in the wet tropics. Of the more than 46,000 families (about 250,000 people) who would directly benefit from the project, some 37,000 families (about 200,000 people) would belong to low income strata and, furthermore, many would receive institutional investment credit for the first time. The project would also help reduce unemployment and underemployment through the creation of 5,000 man-days equivalent per year in addition to the labor requirements during the investment period of the subloans. Apart from the increase in tax revenues from increased production on the farms and in the processing units, the project would also result in important benefits in terms of institutional development.

Date approved: March 9, 1976 (IBRD)

TRANSPORTATION: The main components of this project are: (a) track renewal and renovation of 660 km and 400 km respectively, of principal traffic lines; (b) continuation of a program for reballasting and resleepering of worn out track; (c) bridge strengthening and realignment and improvement of track; (d) drainage and earthworks for station, terminal and marshalling yard extensions, and construction of workshops, depots and other buildings; (e) improvements of signalling and telecommunication facilities; (f) purchase of about 124 new diesel locomotives, 5,800 freightcars, 30 mail vans and 180 passenger coaches, (g) consulting services for civil works and operational improvement programs, and telecommunications and car/train operational control.

Borrower: Ferrocarriles Nacionales de Mexico (N de M).

Loan: $100 million for 25 years at 8.5 percent per annum. Total project cost: $576 million.

Purpose and Benefits: The project consists of a two-year tranche, 1976 and 1977, of the Ferrocarriles Nacionales de Mexico (N de M) Five-Year (1975–1979) Investment Plan. Separate economic analyses were undertaken for six investment categories into which the Plan is divided, accounting for 89 percent of total costs (track renewal, track rehabilitation, realignments and bridges, locomotives and rolling stock, shop equipment and telecommunications and signalling). Generally, the direct effect of these investments, associated with productivity gains resulting from implementing the Plan of Action, will be to enable N de M to carry at reduced cost increasing traffic volumes which would otherwise have to be transported by road at higher economic cost. Economic rates of return for the above investment categories vary from 14 to 35 percent. Based on these results, and considering the remaining investments as overhead, the Plan would yield an economic rate of return of 17 percent.

Date approved: March 30, 1976 (IBRD)

MOROCCO

AGRICULTURE: The loan funds will help finance an irrigation project including: enlargement of the main supply canal (29 km), construction of about 6 km of feeder canal and installation of automatic flow regulators; construction of 4 electric pumping stations with a total installed capacity of about 8,300 kw, and each with an elevated equalizing reservoir; construction of 50 km of 60 kv and 50 km of 22 kv power transmission lines and a substation for pumping stations; land preparation and consoiidation; installation of 416 km of a buried pipe distribution system and associated mobile sprinkler equipment; 52,000 m^3 of excavation for main drainage channels; 108 km of classified road rehabilitation and 85 km construction of new classified roads; construction of farm access roads and windbreaks; construction of buildings and provision of equipment for extension, operating, maintenance, artificial insemination and research services, and installation of a telephone network; construction of six new milk collecting centers; provision of village infrastructure; and the provision of consulting engineering services.

Borrower: Kingdom of Morocco, Regional Agricultural Development Office for the Doukkala (ORMUAD).

Loan: $30 million; 20 years at 8.5 percent per annum. Total project cost: $94.4 million.

Purpose and Benefits: Together with the Beni Amir Rehabilitation Project, the project forms the first phase of a long term program for irrigation development in the Oum-er-Rbia river basin. The main benefit would be a substantial increase in agricultural production which would contribute to meeting domestic demand for sugar, milk, meat, and cereals, equivalent to about $14 million per year at full development, and would generate exports of cotton and vegetables equivalent to about $3 million per year. Incomes of the 3,300 farm families benefitting from the project would be increased by about $9 million per year, an increase of 345 percent. Employment opportunities for these families would increase by about 4,000 man-years per year, mainly during periods of presently low seasonal demand; employment opportunities in crop processing and other project-related activities would also be increased. At present about 95 percent of the beneficiaries receive incomes of less than one-third of the national average. Through its land consolidation component, the project would eliminate fragmentation, thereby improving agricultural efficiency. The rural infrastructure components of the project would improve living conditions for the project beneficiaries. Through the bilharzia control program, the project would improve and protect rural health. The economic rate of return of the irrigation development component of the project, which accounts for 81 percent of project costs, is estimated at 11.4 percent.

Date approved: February 3, 1976 (IBRD)

TOURISM: This project will assist the Government of Morocco in developing Agadir into a major tourism area and to use it as a stimulus to foster further planned growth of the Greater Agadir Area. The project consists of: (i) infrastructure works and public facilities for the development of a new tourism section on 260 hectares, adjacent to Agadir's existing section, and known as Unite d'Amenagement Touristique (UAT), on which hotel accommodations for 7,000 persons and 2,600 housing units are expected to be constructed; (ii) regional infrastructure and facilities for the development of Greater Agadir and its tourism assets; and (iii) related studies.

Borrower: Kingdom of Morocco.

Loan: $21.0 million; 20 years at 8.5 percent per annum. Total project cost: $44 million.

Purpose and Benefits: The project would develop Agadir's tourism potential within the overall development of Greater Agadir and its surroundings. Hotels to be built on the project site would be small to medium sized, and largely sponsored and managed by Moroccans. High tourist demand is expected to continue. The overall financial rate of return for hotels is estimated to average 11.4 percent. When selling about 50 percent of developed hotel sites at market prices and leasing the balance, SONABA would earn a 9.2 percent financial rate of return on its operations. The economic rate of return of the project investment, excluding the Agadir ring road, would be 17.4 percent. The economic rate of return of the Agadir ring road, which represents about 11 percent of the project cost, would be 27.7 percent. The weighted average economic rate of return of the entire project would be 18.5 percent.

Date approved: February 3, 1976 (IBRD)

EDUCATION: The project will support Morocco's program of reforms in the education sector and comprises: (1) design, construction and equipping of 47 primary schools (9,400 student places), 5 secondary schools (6,000 student places), 1 secondary teacher training college (275 student places), 1 hotel training school (180 student places), 4 hotel training centers (540 student places), 1 rural development and extension training center (120 student places), 1 college of public health (replacing 780 student places), 1 medical technicians school (80 student places) and 3 health training centers (240 student places). (2) Detailed preparation and design for 5 technical colleges (4,000 student places), 1 applied engineering institute (240 student places) and 1 technical teacher training college (470 student places) and demonstration school (390 student places). (3) Equipment for a computerization unit. (4) Technical assistance (49 man-years) to operate the computer unit, prepare a national program for technical education and vocational training, and develop curricula.

Borrower: Kingdom of Morocco, Ministry of Education.

Loan: $25 million; 25 years at 4.5 percent per annum. Total project cost: $59.5 million.

Purpose and Benefits: Morocco's education system is academically oriented and highly selective, and much remains to be done to generalize basic education, train middle and higher level technicians and to adapt the system to the needs of the economy. This project would assist the Government in implementing its program to (i) reorient primary education to more effectively meet the needs of rural children and to reduce the present disparities in the distribution of primary schools between rural and urban areas; (ii) reform general secondary education through introducing prevocational subject in the lower cycle and reorienting the upper cycle toward science and technology, (iii) further expand secondary teacher training to help remove costly reliance on expatriates; (iv) expand and improve specialized training to meet urgent manpower needs in agriculture, health and tourism; (v) prepare the launching of a major effort in technical education and vocational training for industry and commerce; and (vi) improve the management of the education system by introducing computerized techniques.

Date approved: March 9, 1976 (IBRD)

TOURISM: These loan funds will help to meet Credit Immobilier et Hotelier's (CIH) requirements for financing import components of specific productive tourism enterprises.

Borrower: The Kingdom of Morocco, Credit Immobilier et Hotelier (CIH).

Loan: $25 million. Repayable substantially in conformity with the aggregate of the amortization schedules for subloans and investments for which withdrawals from the loan account are approved or requested; interest at 8.5 percent per annum.

Purpose and Benefits: CIH's pipeline of tourism projects expected to be approved in the 1976–1979 period now includes 45 new hotels and 6 hotel extensions. These projects would add a total of 16,583 beds to Morocco's current accommodation capacity. On the whole, this pipeline appears sound as 40 hotels would be built or expanded in Morocco's growing tourism demand areas such as the southern region and Casablanca and in heretofore neglected areas with good potential for growth, such as the pre-Saharan and eastern regions. Moreover, the 26 medium category hotels included in the pipeline should fill the short fall in the existing supply of such accommodations. Most of the promoters are experienced hotel companies. To meet commitments of $237 million expected between January 1, 1976–December 31, 1978, CIH would have to raise new resources of $207 million, after deducting uncommitted funds and self-generated resources. CIH's foreign exchange requirements for hotel financing through December 1978 are projected to amount to DH 126 million ($30.4 million).

The proposed Bank loan of $25 million would cover CIH's requirements for commitments through mid-1978. It is hoped that by that time CIH would have succeeded in its ongoing efforts to diversify its foreign borrowings. Gross foreign exchange receipts from tourism represented about 11 percent of the country's total foreign exchange earnings from the export of goods and non-factor services in 1974. Until phosphate prices were raised in 1973, tourism was Morocco's major foreign exchange earner. About 16,000 Moroccans are directly employed in the hotel industry. In addition, some 60,000 jobs in handicrafts and some 20,000 in agriculture, construction industry, transport and other services are generated by tourism demand. Located within easy reach by car, boat and airplane from European tourist generating countries, MOROCCO—Continued

Morocco offers attractive beaches along its extensive Mediterranean and Atlantic coasts, architectural monuments of its four imperial cities of Marrakesh, Fez, Meknes and Rabat and the unique ambiance of its pre-Saharan oases. The diversity of its tourism resources and climatic conditions attracts a heterogenous tourist clientele, including culturally motivated tourists as well as year-round beach vacationers; as a result, tourist traffic to Morocco is more evenly distributed over the year than in many other Mediterranean countries, despite high seasonal fluctuations in the north of the country.

Date approved: May 28, 1976 (IBRD)

POWER: The purpose of the project is to assist in the rational development of water resources in the Oum-er-R'bia basin, and help meet growing demand for electric power, industrial and potable water and water for irrigation development. It consists of: (a) construction of the Al Massira concrete buttress-type dam at Sidi Cheho on the Oum-er-R'bia river and ancillary works; (b) construction of a 120-MW power station at the foot of the dam, including the adjacent 225-kV substation and ancillary works; (c) the construction of about 220 km of 225 kV transmission lines; and the upgrading of 225 kV of substations to be connected to such lines; and (d) the preparation of preliminary designs and bid documents for the Merija compensating dam and power station downstream of Sidi Cheho.

Borrower: Morocco, the National Electricity Office (ONE).

Loan: $49 million; 20 years at 8.85 percent. Total project cost: $167.1 million.

Purpose and Benefits: The main benefits from the project would be the approximate doubling of the power-associated hydro storage capacity in the country, an increase in electric power availability, and provision of water for potable, industrial and irrigation use. These estimates of power generation have been calculated on the basis that the pattern of releases from the dam would be based on water demands for downstream use, to which priority has been given over power generation. Two measures have been used to assess the justification of the project. First, the cost of the multipurpose project was compared with the sum of costs of combinations of alternative projects which would be required to achieve equivalent benefits. This analysis showed that the equalizing discount rate at which the cost of the proposed project would equal the sum of the costs of the alternatives was 12.5 percent. A second measure of the project's economic worth was obtained by preparing an ordinary rate of return estimate; the various benefits are valued in accordance with conventional procedures (i.e. present sales prices for power and water and economic prices for irrigation) and the discount rate is determined which equalizes the multipurpose scheme's costs and benefit. Assuming that prices paid represent the minimum value of the benefit to the consumers, such an approach also would provide a lower limit to the economic rate of return. The rate of return calculated in this way amounts to 9.6 percent.

Date approved: June 24, 1976 (IBRD)

NEPAL

POWER: This project, located about 30 km southwest of Kathmandu, will entail the construction of a 107 m high rockfill dam. The powerhouse would be located underground, containing two 30 MW generating units. A 66 KV double circuit transmission line branch 200 m in length would be required to connect with the existing line between Kathmandu and Birganj. Two 35 MVA transformers would also be needed at the existing substation at Kathmandu.

Borrower: Nepal Electricity Corporation (NEC).

Loan: $26.0 million; 50 years at 0.75 percent per annum. Total project cost: $68.0 million.

Purpose and Benefits: Electrical energy now reaches only about 3 percent of the population in Nepal. Existing generating capacity, even with the considerably higher cost diesel generation, is insufficient to meet demand. Shortages are anticipated and load curtailment will be necessary during the next few years. Such shortages could have serious detrimental impact on industry, tourism and agricultural development. The proposed project is a crucial element in NEC's system expansion program to meet the forecast load requirements. Though the present consumption is mainly in the domestic sector, the major component of the future growth in demand is expected to be in the agricultural, industrial and commercial sectors. About 12 percent of the project's total generating capacity would be required for the Chitwan Valley Irrigation Project alone. In addition, by 1983/84 energy consumption by industrial and commercial users is expected to increase significantly, to account for almost half of total sales. The project would contribute 60 MW in dependable peaking power, 165 Gwh in primary energy and 45 Gwh in secondary energy, annually. The project is the least cost solution for discount rates up to 13 percent when compared with other alternatives which are thermal. The rate of return on project investments would be 10.7 percent based on projected tariff increases. This return does not take into consideration the benefits that could accrue from the potential created for two additional power stations which could be built downstream of the Rapti River, utilizing the regulated flow from the Kulekhani reservoir. Other additional benefits would be the possibility of irrigating about 10,000 hectares, fish production from the reservoir and recreation potential.

Date approved: December 23, 1975 (IDA)

RURAL DEVELOPMENT: This five-year project will help develop the two Hill districts of Nuwakot and Rasuwa by increasing agricultural and livestock production of the 25,000 families living there and would improve communications, health, water supplies and cottage industries.

Borrower: Nepal.

Loan: $8.0 million; 50 years at 0.75 percent. Total project cost: $18.9 million.

Purpose and Benefits: The principal direct benefit to farmers is increased food production which would enable them to meet their full yearly family subsistence requirements instead of 8–9 months as at present. Agriculture and irrigation development would increase net crop incomes by some 50 percent from about $60 to $60 to $91 per family on an average farm size of 0.4 ha. In addition to direct production increases, adoption of improved agricultural practices throughout the project area would help reduce pressures in the Hills to extend cultivation to marginal slopes and would reverse the present trend of declining crop yields. On-farm development during the project period is expected to reduce underemployment on farms but little additional hired labor would be required. Improved rural water supply would reduce the incidence of dysentery and other water-borne diseases (estimated to presently affect nearly 30 percent of children in the project area). Improvement of tracks and new suspension bridges would enhance the communications and accessibility of the project area. Furthermore, improvement of living conditions in the project area would reduce migration and thus would help slow down spontaneous and uncontrolled exploitation of lowland Terai forest. Economic rates of return for the productive components of the project are 29 percent for agricultural development; 27 percent for minor irrigation development; 16 percent for the Batar Irrigation scheme; 15 percent for livestock development and 22 percent for erosion control and soil conservation.

Date approved: February 24, 1976 (IDA)

NICARAGUA

EDUCATION: This project consists of: (i) establishment of 18 Rural Educational Nuclei consisting of 152 four-grade primary schools, 52 six-grade primary schools and 18 rural community learning centers; 9 agricultural training centers; 4 agricultural secondary schools; and 18 lower secondary schools; (ii) in-service training program for upgrading about 1,000 teachers and 100 administrators for the project institutions; and (iii) technical assistance equivalent to 11 man-years of specialist services and 17 man-years of fellowship for local staff.

Borrower: The Republic of Nicaragua, Ministry of Education.

Loan: $11.0 million; 25 years including 7 years of grace at 8.5 percent interest per annum. Total project cost: $19.8 million.

Purpose and Benefits: This third education project will assist the Government in continuing its efforts to develop the country's technical education system and in achieving the objectives of the second education project financed by IDA. Specific benefits are: improvement of technical education planning, decentralizing education management by establishment of regional secondary education centers, and improvement of teacher qualifications through in-service training programs.

Date approved: April 20, 1976 (IBRD)

NIGER

RURAL DEVELOPMENT: The project, carried out over a three-year period, 1976–78, would comprise: (a) provision of production packages—extension, applied research, credit and input supply—aimed at the improvement of groundnut, millet and cowpea production in 15 selected Associations Locales de Cooperatives (ALCs); (b) strengthening of cooperatives; (c) expansion of educational and training programs, including a functional literacy program, as well as of a training school for extension workers and the provision of training scholarships for project personnel; (d) study for developing the irrigation potential of the Goulbi de Maradi and pilot development of irrigation in the Goulbi de Maradi through exploitation of underground water resources; (e) construction of 80 km of feeder roads; (f) planting of 500 ha of trees in fuel wood plantations; (g) improvement of livestock services in the project area and preparation of a livestock development project, as well as provision of credit for the purchase of livestock by pastoralists who lost their herds during the Sahelian drought; and (h) establishment of a project evaluation unit to determine the economic and social impact of the project.

Borrower: Republic of Niger.

Loan: $10.7 million; 50 years at 0.75 percent per annum. Total project cost: $13.2 million.

Purpose and Benefits: The overall impact of the project, at full development in 1982, is expected to raise future average yields in the 15 project area ALCs to close to those obtained in the years of most favorable rainfall over the period 1967–75. Farmers' gross income from crop production, at 1975 prices, excluding any income from participating in either the irrigation or the livestock component of the project, would increase some 47 percent between 1976 and 1982, and net income per day worked would increase from an average of $0.80 to $1.32 by 1982. Net income from a 0.50 ha irrigation holding is estimated to amount to $298 by the fourth year of its development after payment of all direct expenses and provision for capital recovery. The project's direct benefits would be the increased production it would generate which would result in higher incomes for some 37,500 farm families and 14,000 pastoral families. The economic rate of return from investment in the project is estimated at 39 percent over 25 years.

Date approved: December 11, 1975 (IDA)

TRANSPORTATION: This project, to be carried out over the three years 1976–1978, comprises: (a) implementation of a four-year program of periodic maintenance, including procurement of equipment and training of specialized Directorate of Public Works and Urban Affairs (DPW) staff at all levels; (b) construction and improvement of the roads Zinder-Nigerian border (about 113 km), and Maradi-Nigerian border (Djibiya) (about 49 km) and (c) consulting services for: (i) technical assistance required under item (a) above; (ii) supervision of road construction; and (iii) a survey of the domestic construction industry.

Borrower: Republic of Niger, Directorate of Public Works and Urban Affairs (DPW).

Loan: $15.6 million; 50 years at 0.75 percent. Total project cost: $28.7 million.

Purpose and Benefits: Overall, the maintenance and construction works under the project are expected to result in reduced vehicle operating costs and increased efficiency of the road transport industry. Reduced vehicle operating costs will directly benefit the owners of commercial vehicles; since transport prices in Niger are determined in a competitive framework, a substantial part of this benefit should be passed on to producers and consumers. There would also be government savings in future road rehabilitation costs. The maintenance program is expected to lead to the following direct benefits: (i) reduction in vehicle operating costs; (ii) increase in seasonal use of roads which play a vital role in the country's economic development; and (iii) reduction of the per kilometer cost of regravelling operations. The economic return for the maintenance program which represents 24 percent of project costs (net of taxes) is about 28 percent. The direct benefits of the construction of the proposed Zinder-Nigerian border road (113 km) will derive from distance savings, reduced vehicle operating costs, and savings in maintenance costs. In addition to the benefits from diverted and local traffic, the analysis also includes generated traffic of light vehicles. The estimate of economic return for construction of this road which represents 49 percent of project costs (net of tax) is 13 percent. The benefits applied in the analysis of the construction of the Maradi-Nigerian Border Road (49 km)

NIGER—Continued

have been quantified and expressed in road user savings and savings in future maintenance costs. The return on this road which represents 27 percent of project costs (net of taxes) is about 16 percent. The weighted average return for the project is estimated at about 17 percent.

Date approved: February 17, 1976 (IDA)

TELECOMMUNICATIONS: This project involves the installation of 3,800 lines of automatic switching equipment with cable and subscriber distribution networks; improvement of long-distance services by providing trunk switching equipment, three VHF links and one HF radio link, overhead line and carrier equipment; civil works; miscellaneous equipment, vehicles and tools; and 30 man-months of engineering consultants services; 18 man-months of financial consultants services.

Borrower: Republic of Niger, Office des Postes et Telecommunication du Niger (OPTN).

Loan: $5.2 million; 50 years, including 10 years of grace, at 0.75 percent per annum. Total project cost: $6.5 million.

Purpose and Benefits: The present lack of reliable, good quality telecommunications facilities in Niger, especially in the case of the long-distance network is causing acute communications problems; the inadequacy of the facilities was clearly demonstrated during relief operations consequent upon the Sahelian drought. The economic costs of such inadequate telecommunications between the major centers of a landlocked country as large as Niger must be very substantial, and the improvement of telecommunications is recognized by government as a key element in the development process and in the better integration of the country. OPTN's 1976–79 development program addresses itself to these issues and aims at bringing about a quick and substantial improvement in the quality of the country's telecommunications services. The program lays stress on the improvement of the long-distance services and is designed to improve the quality of service in the economically more important areas of Niger. These areas include the regions of Maradi and Zinder, (both of which are subjects of externally financed regional development efforts, the former by IDA), the fertile areas of the Niger Valley, and the important departments of Niamey, Dosso and Tahoua. Modern local and long-distance facilities will improve the quality of service available to the producers, merchants, exporters, consumers and carriers, and to the regional and local government services of these areas. In addition to the installation of new equipment in the southern and basically agricultural belt, new facilities are to be provided for in the mining areas of the midwest of the country, where demand for telecommunications service is developing fast. These new installations would assist the development of the areas concerned, meet an urgent need and provide the basis for the future extension of service. The project as designed represents the least-cost solution for the proposed development.

Date approved: June 3, 1976 (IDA)

PAKISTAN

AGRICULTURE: The loan funds will provide a supplemental contribution to the Tarbela Development Fund to help meet the foreign exchange costs of certain repairs and additional remedial works for the Tarbela Dam.

Borrower: Islamic Republic of Pakistan, Tarbela Development Fund.

Loan: $8.0 million (Supplemental); 50 years at 0.75 percent per annum. Total project cost: $59 million (Supplement).

Purpose and Benefits: After some initial difficulties, the major civil engineering works for the Tarbela Dam project were constructed on schedule and by the middle of August 1974, the main embankment dam had been completed. Progress on the construction of the powerhouse and installation of generating plant, to be commissioned near the end of 1975, was also on schedule. The impounding of the reservoir began in July 1974. Owing to the complex geological nature of the foundations, it had been decided to test fill the reservoir slowly and, in order to facilitate the emergency "dumping" of the reservoir, should this prove necessary, the inlet gates to Tunnels 1 and 2, originally intended to operate only as closure gates, were modified so that they could be both opened and closed under hydraulic head. Shortly after the filling began, it was discovered that the center gate of Tunnel 2 could not be fully closed. Then some of the steel liner plates ripped off one of the outlet passages of Tunnel 3, whereupon, as a precautionary measure, all the outlet gates to Tunnels 3 and 4 were closed, and the reservoir began to fill at an increasing rate. The next incident was the partial collapse of 200 feet of Tunnel 2 in the inlet area and the cave-in of the abutment above the area of collapse. Following this event, a decision was made to empty the reservoir. There was considerable cavitation damage in Tunnels 1 and 2 and, as mentioned above, the liner plates in Tunnel 3 outlet were stripped. A number of sink holes were also found in the upstream blanket. Seepage through the relief wells at the toe of the dam and through the right abutment was more than had been expected. Damage of a less serious nature was caused by the turbulent flows of water in the outlet area downstream of the dam. The additional funds will complete the project, thereby enabling Pakistan to derive the benefits from the additional power and irrigation water available. Nevertheless, in spite of the supplemental funds needed, the economic return on the project still exceeds 10 percent. The dam must also be completed for any of the benefits to be realized.

Date approved: July 22, 1975 (IDA)

POWER: These loan funds will help finance the expansion of the Water and Power Development Authority (WAPDA) power transmission facilities by construction of approximately 336 miles of a 500 kV single circuit transmission line between Lyallpur, Multan and Guddu, to be operated initially at 200 kV; installation of a 200 kV switching station at Multan and of a transformer repair bay at Lyallpur; engineering and supervision services, training in 500 kV system operation, and accounting and management consulting services.

Borrower: Islamic Republic of Pakistan, Water and Power Development Authority (WAPDA).

Loan: $50.0 million; 25 years at 4.5 percent per annum. Total project cost: $113.8 million.

Purpose and Benefits: The project, which will connect Lyallpur with Multan and Guddu (336 miles), forms only a part of the ultimate north-south interconnection. Given the complexities of the operation of the entire system it is difficult to quantify all the benefits attributable to the project and, therefore, to calculate its internal economic return. The justification of the complete 500 kV transmission scheme, and therefore of the project, rests basically upon the benefits, many of which are difficult to quantify, brought about by interconnected systems, e.g., pooling of generating plants of different operating characteristics, reduction in the total reserve plant capacity required for a reasonable standard of service, a reduction in the aggregate demands of the regions by virtue of diversity, ability to locate power stations at optimum sites and of optimum characteristics to take advantage of economies of scale, and flexibility to allow the best positioning of tapping of load points. The project is not expected to create environmental problems.

Date approved: February 10, 1976 (IBRD)

AGRICULTURE: This project will (a) establish and equip Provincial Seed Corporations in Punjab and Sind and finance pilot projects for vegetable and potato seed production in Baluchistan, NWFP, and Punjab; (b) develop Corporation and private seed farms and provide technical assistance and training to the seed industry; and (c) establish and/or equip a National Seed Certification Agency, Registration Agency and Research Institutes.

Borrower: Islamic Republic of Pakistan, Seed Corporation.

Loan: $23 million; 50 years at 0.75 percent per annum. Total project cost: $56.5 million.

Purpose and Benefits: The main benefits of this project will be the higher crop yields obtained by the users of the improved seed produced by the project. At full production, users of improved seed, replaced at assumed rates, should obtain yield increases of 20 percent for maize and 10 percent for wheat, rice and cotton. In addition, significant quality improvements and, consequently, better prices should be realized in the case of cotton.

Date approved: March 16, 1976 (IDA)

PROGRAM CREDIT: These loan funds will help to meet the foreign exchange requirements for Pakistan's imports of essential capital and intermediate goods to support agricultural and industrial development.

Borrower: Pakistan.

Loan: $50 million; 50 years at 0.75 percent per annum.

Purpose and Benefits: The case for program assistance to Pakistan rests essentially on three grounds: First, the Government has formulated, for the period through FY 1977, a program of action that addresses the three major problem areas in the performance of the economy in recent years—agricultural production, mobilization of domestic resources, and exports—and has taken initial steps towards its implementation. Second, the Government has recognized that the problems besetting the economy at present can be overcome only by a sustained effort on its part to strengthen economic management; to that end, it has committed itself to a set of policy objectives for the longer-term as set out in the Planning Commission's draft of the Fifth Five-Year Plan that would sustain the efforts begun under the program for next year. Third, the limited foreign exchange resources currently in sight for FY 1977 for financing imports other than those directly related to externally assisted projects, would very severely constrain the Government's ability to give effect next year to that part of its action program which in many ways holds the key to its longer-term strategy, namely the acceleration of growth, particularly in the agricultural sector.

Date approved: May 18, 1976 (IDA)

WATER SUPPLY AND SEWERAGE: This project involves the improvement and expansion of water supply, sewerage and drainage in the Lahore metropolitan area and urban and traffic studies as follows: (1) Water Supply: The construction of about 47 tubewells and about 5 miles of tubewell associated transmission mains and the construction or rehabilitation of about 38 miles of main grid and about 150 miles of distribution network; (2) Sewerage and Drainage: The construction of about 17 miles of trunk sewers, about 285 miles of collector sewers, 4 new pumping stations and the extension of 1 existing pumping station and a prototype waste stabilization pond of about 75 acres; (3) Administration: Studies, technical assistance, facilities and training for improved institutional capabilities.

Borrower: Islamic Republic of Pakistan, Lahore Development Authority (LDA), Water and Sanitation Agency (WASA).

Loan: $26.6 million. The terms are for 50 years at 0.75 percent per annum. Total project cost: $47.9 million.

Purpose and Benefits: Only about one-quarter to one-third of the population in Lahore receives direct sewer service and during the monsoon, flooding is frequent. The project will help to alleviate these problems through improving WASA's efficiency and capability, extending water supply, sewerage and drainage services and reducing waterborne and fecal related diseases. Specifically, the project will: (a) increase the water service connections by 60 percent from 120,000 to 195,000 and the population served by 43 percent from 1.4 million to 2.0 million; (b) increase the sewered area by about 20 percent from which about 250,000 persons will derive benefit; and (c) improve the operations and institutional capabilities of WASA.

Date approved: May 18, 1976 (IDA)

IRRIGATION: These loan funds will help to finance: (a) installation of a subsurface tile drainage system, including 1,600 miles of buried tile and collector drains; (b) enlargement and remodelling of irrigation canals and structures; (c) construction and rehabilitation of about 270 miles of new water-courses; (d) reorganized and intensified agricultural extension services; (e) provision of equipment, vehicles, materials and supplies necessary for the construction of project works, and the provision of credit to farmers and land-levelling contractors; (f) provision of aerial photographs and the preparation of specialized maps; and, (g) the provision of technical assistance and training.

Borrower: Pakistan, Water and Power Development Authority (WAPDA).

Loan: $14 million; 50 years at 0.75 percent per annum. Total project cost: $28.3 million.

Purpose and Benefits: With the drainage and improved water distribution facilities to be provided under the project, farmers would be able to reclaim and restore the productivity of lands that have become saline or waterlogged, thus opening the way for substantial yield increases and the cultivation of land not now in production. Under the project, the overall cropping intensity is expected to rise from the present 86% to almost 150%. The value of additional output from the project area, less the cost of production inputs, is estimated at $11 million equivalent annually, of which about $5.8 million would accrue in the form of net foreign exchange savings/earnings. Farm and tenant incomes would increase two and one-half to three times as a result of production increases due to the project and, in addition, employment opportunities, largely for landless families in the area, would double. It is estimated that the project would directly improve the earning capacities of more than 85% of all households in the project area. Moreover, the

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experience and information gained from this project will be useful in planning the development of other areas covering several million acres in the Indus Basin where similar constraints exist. The project's economic rate of return is estimated to be about 17%.

Date approved: June 24, 1976 (IDA)

PANAMA

WATER SUPPLY AND SEWERAGE: This project forms part of the Instituto de Acueductos y Alcantarillados Nacionales (IDAAN) 1976–80 investment program and involves improvements in the water supply and sewerage systems in the cities of Panama, Colon, Chorrera, and Arraijan, and the fishing port of Vacamonte. It also provides for institutional and operational improvements in the sector.

Borrower: Republic of Panama, Instituto de Acueductos y Alcantarillados Nacionales (IDAAN).

Loan: $12 million; payable in 20 years, including 4 years of grace, at an interest rate of 8.5 percent per annum. Total project cost: $20.5 million.

Purpose and Benefits: The project will (i) provide water to about 106,000 of the poorest people living in Panama City and suburbs of Colon by expanding the distribution systems to low-income areas of those cities; (ii) increase the production and transmission capacity of the Colon water supply system by one-third and rehabilitate its existing distribution system; (iii) provide adequate water supply to the low-income towns of Chorrera and Arraijan, near Panama City; (iv) supply water to the fishing port of Vacamonte; (v) reduce waste and losses in the existing systems so that unaccounted-for water does not exceed 25 percent of production, which is considered an acceptable level; (vi) improve the sewerage system in Panama City's low-income district of El Chorillo; and (vii) improve the efficiency of IDAAN's management and operations. The internal financial rate of return is estimated to be 7 percent for the Colon subproject, the cost of which is US$6.3 million; 26 percent for the Panama sub-project, the cost of which is US$2.2 million; 9 percent for the Chorrera sub-project, the cost of which is US$3.1 million; and 6 percent for the Arraijan sub-project, the cost of which is US$0.5 million. The average internal financial rate of return of these components, which account for 66 percent of the total project cost, is 11 percent.

Date approved: May 28, 1976 (IBRD)

PARAGUAY

PREINVESTMENT: The project would finance the cost of hiring consultants: (a) to prepare 12 specific investment projects; and (b) to give short-term specialized support to the National Projects Office, for planning and review of studies.

Borrower: Republic of Paraguay, Central Bank of Paraguay (Pre-investment Fund).

Loan: $4.0 million; 50 years at 0.75 percent.

Purpose and Benefits: The strengthening of the National Projects Office would help increase the number of well prepared high priority projects in the public sector, encouraging better resource allocation, improved budgeting, and effective coordination of external financial assistance, thereby contributing to maximize the benefits derived from the public investment effort. For purposes of illustration, however, an attempt was made to determine under what minimum conditions the project would be justified. The analysis showed that the project would yield an internal rate of return of 12 percent if it were to lead to investments totalling $143 million over a seven-year period (about 50 percent of the maximum potential investment), and if cost savings specifically attributable to the project were to reach at least 4.2 percent of the investment generated. Experience in Paraguay has shown that cost savings to be attained as a result of better project preparation can far exceed this minimum level.

Date approved: August 21, 1975 (IDA)

EDUCATION: The project comprises: (a) expansion (construction, furnishing and equipping) of vocational training centers in Asuncion and San Lorenzo, increasing the existing capacity from 205 to 545 trainee places; (b) construction of four new vocational training centers in Hernandarias (Itaipu), Encarnacion (Yacyreta), Chore and Coronel Oviedo providing 495 trainee places; (c) two mobile training units and twenty-four sets of equipment and transport for about 1,500 trainees; and (d) technical assistance comprising: (i) 7 man-years of expert services and 3 man-years of expert services for inplant training; (ii) ½ man-year of expert services for equipment specification; and (iii) 2½ man-years of fellowships to train supervisors of regional centers.

Borrower: Republic of Paraguay, National Vocational Training Service (SNPP).

Loan: $4 million; 25 years at 4.5 percent per annum. Total project cost: $5.7 million.

Purpose and Benefits: This project will contribute to reducing the critical shortage of manpower for development projects, particularly in the agricultural and power sectors, and also help increase the managerial capacity of the country, which is considered to be a major bottleneck for the growth of the industrial sector. At full development of the project by 1980–85, the annual output of SNPP trainees is expected to almost quadruple, and around 450 persons would receive managerial training annually. With regards to the education sector, the project would promote greater relevancy of education to the overall needs of the economy by strengthening SNPP, which is the major institution for non-formal vocational training in Paraguay. Finally, the project would help increase the employment and earnings opportunities among the lowest groups on the income scale, including underemployed rural youth and the urban unemployed. Steps would be taken through the proposed project to strengthen SNPP's organization and management by providing technical assistance, and by relying on only a few fixed training centers and several mobile training units. This strategy would provide the needed flexibility in meeting training needs without putting undue strain on the management. Special provision has also been made under the project for the Government to evaluate annually SNPP's activities to ensure their efficiency and relevancy.

Date approved: May 4, 1976 (IBRD)

PERU

TRANSPORTATION: This project consist of: (1) improvement of 375 km of road between Lima and Pucallpa and access road to Pucallpa and its river port; (2) improvement of 110 km of feeder roads; (3) construction of river ports at Yurimaguas and Pucallpa and expansion of the river port at Iquitos; (4) procurement of road maintenance equipment and installations; (5) procurement of hydrological equipment; and (6) consulting services.

Borrower: Republic of Peru.

Loan: $76.5 million; 25 years at 8.5 percent per annum. Total project cost: $128.7 million.

Purpose and Benefits: The project is economically justified with an overall economic rate of return of 23 percent for the road element and 22 percent for the port component. The project is expected to have an important developmental effect in both the Jungle Region and the areas to be served by the roads component of the project by reducing transport costs and, hence, promoting economic activity. At present, transport costs along the corridor vary from 10 percent to 29 percent of the wholesale market prices of the main products of the Jungle Region. It is, therefore, expected that the reduction of transport costs resulting from this project will have an important positive development impact on the area, as has been already experienced under past transport projects along the corridor.

Date approved: December 30, 1975 (IBRD)

POWER: The project consists of: 1) expansion program of Electrolima for 1975–78, including the following major elements: a. *Transmission and subtransmission:* i. 26 circuit-km of 220 kV and 125 circuit-km of 60 kV line extensions; ii. construction, expansion and/or improvement of six 220/60 kV substations and of 17 existing 60/10 kV substations. b. *Distribution:* i. installation of about 300 transformers, 10,000/220 V, with an aggregate capacity of about 233 MVA; ii. installation of about 1,000 circuit-km of 10 kV lines; iii. installation of 200,000 meters. c. *Auxiliary services:* i. expansion of the existing communications and control center; ii. auxiliary equipment for the data processing center; iii. laboratory, shop, transportation and maintenance equipment. d. *Consultant services and training:* (25 man-months) i. consultant services for the expansion of the communications and control center, for a review of distribution planning standards, and for hot-line maintenance of overhead distribution and transmission lines; and ii. training of maintenance personnel in hot-line maintenance of overhead distribution and transmission lines. 2) Technical assistance for the Government (170 man-months), which will include: a. a study of the organization of the power sector to suggest ways of improving the coordination between sector entities and efficiency, and identify sector training requirements; b. the preparation of a master plan for future generation and transmission additions in the north-central interconnected system of the country; c. a power tariff structure study; and d. training of sector personnel in operation, planning and administration.

Borrower: Republic of Peru, Electrolima.

Loan: $36 million; 20 years at 8.5 percent per annum. Total project cost: $137.4 million.

Purpose and Benefits: By providing facilities to expand Lima's distribution system and meet future demand for electricity in that city, which accounts for 35 percent of the national market, an important constraint for future growth will be removed. Also, the project would be instrumental in making available public-service electricity to the poor settlements in the outskirts of the city of Lima *(pueblos Jovenes)* since Electrolima would build distribution facilities in them, including the necessary substations and transmission lines. It is expected that the number of households in *pueblos jovenes* with public-service electricity would increase by about 300 percent by mid-1979, thereby contributing to alleviate the present poor living conditions of those areas of Metropolitan Lima. In addition planning and management of the power sector would be strengthened by the technical assistance component of the project through providing the Government with a master plan, aiding the Government in organizing the sector more efficiently and training of key administrative, operative and planning personnel. The economic rate of return of the project can be estimated to be no less than 9 percent and under plausible assumptions, may be as high as 15.7 percent.

Date approved: March 3, 1976 (IBRD)

URBANIZATION: This project includes: (a) Infrastructure: (i) water and sewerage for *pueblos jovenes* in Lima and Arequipa providing about 7,200 household connections; (ii) electrification of 16,300 households in *pueblos jovenes* in Lima and Arequipa; (iii) access roads of 86.1 km to connect *pueblos jovenes* to main roads and upgrade existing roads in these settlements; and (iv) health and nutrition centers in *pueblos jovenes* in Lima. (b) Productive investments: (i) industrial sites and services (about 63.5 ha) in Lima and Arequipa; (ii) housing and commercial sites and services in Lima; and (iii) supervised credit in Arequipa. (c) Technical assistance: (i) to establish a technical assistance unit in the Ministry of Housing and Construction to assist settlers primarily in self-help construction; (ii) to provide advisory assistance for the planning, management and monitoring of the industrial sites and services in Lima; (iii) to assist in the review of plans and in the preparation of a water supply and sewerage project in Arequipa; (iv) to provide advisory assistance as well as vehicles and equipment for the development of a training program for community health and nutrition in *pueblos jovenes;* and (v) to assist the Banco de la Vivienda del Peru in overall project implementation, financial planning and related studies for the mobilization of additional resources for urban development program and future projects.

Borrower: Republic of Peru, Banco de la Vivienda del Peru (BVP).

Loan: $21.6 million; 20 years at 8.85 percent per annum. Total project cost: $43.2 million.

Purpose and Benefits: The primary objective of the project is to contribute to the economic and social advancement of residents of *pueblos jovenes.* The various components of the project will extend essential services, provide basic employment training and increase the productivity of the urban poor. It is expected that about 6,000 new permanent jobs will be created by encouraging the establishment of small- and medium-size industries in the industrial sites to be provided under the project, together with the provision of industrial training and capital provided under broader government schemes. The average rate of return has been estimated at 30%.

Date approved: June 8, 1976 (IBRD)

INDUSTRY: The project comprises: (a) The Cobriza Mine Expansion: The project would expand underground mine production from 0.7 million STPY of ore grading 2.2 percent copper to 3.5 million STPY grading 1.8 percent copper. This ore will be treated in a new concentrator, increasing concentrate output from 50,000 STPY to 223,000 STPY containing 25 percent copper and 5.5 oz. of silver/ton. Related administrative, industrial and social infrastructure are also included in the project. The existing concentrator will be dismantled, with some of the equipment to be used in the new concentrator, to be constructed on a more stable site. (b) The Cerro de

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Paso Mine Water Treatment Plant: This project would improve the economics of copper recovery by replacing an existing cementation plant with a more efficient solvent extraction and electro-winning plant producing refined copper in place of cement copper, and eliminating CENTROMIN's pollution of the San Juan and Mantaro rivers. Production of copper would be 7,000 STPY by 1979.

Borrower: Empresa Minera del Centro del Peru (CENTROMIN).

Loan: $40 million; 15 years at 8.5 percent per annum. Total project cost: $146.5 million.

Purpose and Benefits: The estimated economic rate of return for the Cobriza project, which represents about 91.5% of total project cost, is about 16% and for the Cerro de Pasco project is about 20 percent. The weighted average rate of return is estimated at 16.3 percent. The proposed projects and the Stage I Program will help accelerate the country's economic growth and maintain Peru's market position in a number of key minerals. The net annual foreign exchange benefits generated by the Stage I Program are projected to reach about $59 million equivalent in 1975 dollars by 1982 of which the two projects to be financed by the IBRD and IDB represent $30 million. The Government will benefit greatly through the increased fiscal and profit sharing revenues, and the foreign exchange earned by the projects. The workers too, will benefit, with expanded incomes under the existing profit sharing arrangements. An additional 700 jobs will also be created by the Stage I expansion.

Date approved: June 30, 1976 (IBRD)

PHILIPPINES

AGRICULTURE: The project includes: (a) modification of the existing Magat River Irrigation System (MARIS) diversion dam; (b) rehabilitation of existing National Irrigation Administration (NIA) irrigation and drainage systems and several local communal systems serving a total area of about 12,190 ha; (c) extension of NIA Systems to serve an additional area of about 22,810 ha; (d) upgrading and construction of about 830 km of project roads; (e) construction of an air strip, access roads and a bridge across the Magat river near the MARIS diversion dam; and (f) procurement of vehicles and equipment. The project will also provide for (i) detailed engineering studies and full economic evaluation of the Magat dam and reservoir, (ii) a water management training program and (iii) technical assistance to NIA in systems operation and construction management.

Borrower: The Republic of the Philippines.

Loan: $42 million; 25 years at 8.5 percent per annum. Total project cost: $84.0 million.

Purpose and Benefits: The Stage I project would contribute to the Philippine Government's objectives of attaining self-sufficiency in food grains and improving the productivity of small farmers. In so doing, it would help strengthen the balance of payments and raise rural incomes. The project would provide better water control and would extend the area under run-of-the-river irrigation from 40,000 ha to 75,000 ha in the wet season and from 19,000 ha to 29,000 ha in the dry season. Yields would increase due to improved irrigation, drainage and agricultural supporting services. At full development, annual paddy production in the project area would increase from the present level of 189,000 tons to 422,000 tons, enough rice to feed some 800,000 persons per year. Net foreign exchange savings as a result of reduced rice imports would be about $27 million a year. Per capita incomes on average size farms would increase from a weighted average of about $105 at present to about $220 in 1985. Assuming a 50-year project life, prices for rice and fertilizer based on the Bank's commodity price forecasts and a seasonally variable shadow wage rate for unskilled farm labor, the economic rate of return on the Stage I project is estimated to be 18 percent.

Date approved: July 22, 1975 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: The loan would be used to finance direct capital goods import requirements of eligible industrial and other enterprises, i.e. manufacturing, agro-industries, mining, ocean-shipping, tourism, etc. and the identifiable direct foreign cost of imported goods purchased from domestic fabricators. The loan would also be used to finance the permanent working capital requirements of eligible sub-projects.

Borrower: The Republic of the Philippines, Development Bank of the Philippines (DBP).

Loan: $75 million, 18 years at 8.5 percent.

Purpose and Benefits: The proposed loan will contribute to achieving two important objectives in Bank assistance for the Philippine development program. First, it will continue to provide resources on more appropriate terms for Philippine industrialization, and in particular for balancing the industrial structure and strengthening the manufacturing export sector. The loan would be directed mainly towards investments which would: (i) further diversify the non-traditional export base; (ii) encourage greater domestic value added through downstream domestic processing of traditional exports; and (iii) encourage investments in intermediate and capital goods production. Second and equally important, the loan will enable the Bank to strengthen its relationship with DBP and to continue the process of institution building. This objective is central to the project. The beneficial implications of achieving improvements in: the resource allocation and mobilization capacity of an institution with the economy-wide impact of DBP; the soundness of its financial structure; and in strengthening its operating procedures and management, are obvious. Clearly major improvements will not be achieved very quickly and expectations of progress need to be realistic. While problems still remain to be solved, the progress achieved by DBP in the last 18 months has not been insignificant. The proposed second loan is expected to result in further gradual improvement in the following areas: (i) the quality of DBP's industrial project appraisal; (ii) the quality of industrial project supervision; (iii) the quality and quantity of staffing in IPD–I; (iv) reduction in the growth of DBP's contingent liabilities; (v) strengthening of its long-term resource base; (vi) improvements in earnings performance through improved collections and a more appropriate level of rates and charges; (vii) reduction in arrearages; (viii) more adequate provisions for risks and reserves; and (ix) major improvements in the quality of auditing and internal reporting.

Date approved: December 16, 1975 (IBRD)

AGRICULTURE: The Philippine Government will relend $19.8 million equivalent from the proceeds of this loan to the Development Bank of the Philippines (DBP) on the same terms as those of the Bank loan. DBP would onlend the funds to private sub-borrowers and municipalities for livestock enterprises. Sub-loans would carry an interest rate of 12 percent per annum for small loans of less than $670 and for those fully secured by land and 14 percent per annum for other loans.

The project consists of a program of credit by DBP to assist in the development of pig, poultry, and cattle enterprises, and in the establishment, replacement or upgrading of about 10 small municipal slaughterhouses; a program to offer formal training, including retraining and on-the-job instruction on livestock development to an adequate number of staff members of DBP.

Borrower: Republic of the Philippines, Development Bank of the Philippines (DBP).

Loan: $20.5 million. The loan would be for a term of 14½ years, including a grace period of 5½ years at an interest rate of 8.5 percent per annum. Total project cost: $41.3 million.

Purpose and Benefits: The project would continue the institution-building role begun under the First Project by strengthening the Livestock and Poultry Group of DBP and the DBP branches and by involving the Bureau of Animal Industry in the project more directly in support of DBP's lending program. Incremental net income to the 3,050 farm families participating in the project would average $2,210 per annum at full development with a range from $410 to $6,300. The present incomes of these families cover a wide range, but it is estimated that about 1,300 farm families with an annual income of less than $800 per annum would benefit from the project. At full development (Year 11), the project would generate some 5,800 permanent jobs and indirectly a large number of jobs in the production of feedstuff, transportation and marketing. It would result in net foreign exchange savings of $17 million a year at full development. Social benefits of the project would be substantial, since about 80 percent of direct and indirect beneficiaries are within the target rural poverty group with a per capita income of less than $140.

Date approved: March 16, 1976 (IBRD)

EDUCATION: This project consists of: (a) constructing, furnishing and equipping two new and, furnishing and equipping three existing, curriculum development centers; plus furnishing and equipping the textbook board; (b) curriculum development, writing, testing and revising textbooks (about 71 titles) for five primary and five secondary school subjects; (c) training of about 250,000 public elementary and secondary teachers in the use of the new textbooks; (d) equipping 14 staff development centers and 34 development high schools for testing textbooks and teacher training; and (e) constructing, furnishing and equipping one national and 107 provincial and sub-provincial warehouses.

Borrower: Republic of the Philippines, Department of Education and Culture.

Loan: $25 million. Repayment in 25 years, including seven years of grace, with interest at 4.5 percent per annum. Total project cost: $51.6 million.

Purpose and Benefits: Insufficient and outdated textbooks have been a major contributing factor to low educational quality. The project will provide both the institutional development and increased textbook supply necessary for sustained improvement of educational quality. Under the project, the Textbook Board would be strengthened in authority and expertise to initiate, coordinate, execute and supervise the full complement of textbook publishing functions. The presently dispersed activities associated with textbook development (curricula development, manuscript preparation, testing, production, manufacture and distribution) would be integrated under the single management of the Textbook Board. The wider span of authority of the Board would enable it to undertake a systematic program for developing new textbook titles. The increased supply of 27 million books should allow the pupil/book ratio per subject to be reduced from 10:1 to 2:1. Not only would this help raise individual learning achievements, but the distribution of uniform textbooks equitably throughout the country would help equalize educational standards between urban and rural areas. The provision of adequate textbooks together with improved teacher training would be an important step toward improving curricula and classroom practices. It should also reduce repeater and dropout rates.

Date approved: March 16, 1976 (IBRD)

AGRICULTURE: The project includes construction of a diversion dam and intake works on the Chico river; the rehabilitation of an existing 1,400 ha irrigation system and construction of a drainage system; and the improvement of provincial roads.

Borrower: The Republic of the Philippines.

Loan: $50 million. The loan would be for a term of 25 years, including a six-year grace period with the interest rate at 8.5 percent per annum. Total project cost: $84 million.

Purpose and Benefits: The project will provide better water control, improved drainage and the necessary agricultural supporting services and thus increase rice yields and production on the 19,700 ha. It would increase dry season irrigation from 5,000 ha at present to 17,000 ha at full project development and in so doing would provide the equivalent of an additional 4,700 full-time jobs. Total paddy production in the project area would increase from the present level of 50,000 tons to 147,000 tons per annum. The increase would provide enough rice to feed 600,000 persons per year and the net foreign exchange savings would be $20 million a year at projected world market prices. The project's irrigation component would benefit directly some 8,000 farm families and 2,000 landless families, or a total of 55,000 people. The great majority of these people currently have very low incomes. The road component would improve access links between the irrigation service areas of the Magat and the proposed Chico projects and existing national highways and, thereby, reduce the cost of transporting farm inputs and production.

Date approved: March 23, 1976 (IBRD)

AGRICULTURE: This project consists of a program of credit by the Development Bank of the Philippines (DBP) to assist in modernizing and expanding the Philippines grain processing industry. It would include the construction, expansion and rehabilitation of about 135 rice and 20 corn processing facilities to be owned and operated by private individuals and corporations with prior experience in grain processing and trading.

Borrower: Philipines, Development Bank of the Philippines (DBP).

Loan: $11.5 million; 18 years at 8.5 percent per annum. Total project cost: $28.5 million.

Purpose and Benefits: The project will continue the process of replacing old or inefficient mills by modern, high recovery mills, and would help provide the milling, drying, storage and transport facilities needed to support increased rice and corn production in the Philippines.

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The project would also help improve rural incomes by providing more secure and competitive outlets for farmers' products. At full development, the 135 rice mills and 20 corn mills to be financed under the project would produce annually 207,000 tons of milled rice with a wholesale value of $48 million, 72,000 tons of milled corn with a value of $11.4 million and 60,000 tons of by-products (mainly bran) with a value of $7 million. The improved facilities would reduce post-harvest grain losses by an estimated 17,000 tons of grain per year, would increase rice milling recovery rates resulting in a net increase of about 7,000 tons of milled rice per year, and induce increased production of about 21,000 tons of grain in areas now without adequate processing facilities. The project is expected to result in foreign exchange savings of about $11 million per year. The estimated financial rates of return on investments vary from 25 percent for one ton capacity rice mills to 28 percent for the corn mills, with a weighted average of 27 percent. The corresponding economic rates of return range from 16 to 30 percent, with an overall weighted average for the project of 28 percent.

Date approved: May 25, 1976 (IBRD)

AGRICULTURE: The project will assist the Government in carrying out a program of increasing fish production for domestic consumption through financing to be administered by the Development Bank of the Philippines (DBP) for the following: Inland Sector: (i) construction of about 115 new fishponds for fish farming; (ii) expansion and rehabilitation of about 265 existing fish ponds; Marine Sector: (iii) construction of about fourteen 90-gross ton fishing vessels; (iv) construction of three 45-gross ton fishing vessels, (v) conversion of four second-hand vessels into fish carrier boats; (vi) construction of three ice plants with cold storage; and (vii) construction of a slipway for repair of fishing vessels.

Borrower: Republic of the Philippines, Development Bank of the Philippines (DBP).

Loan: $12.0 million; 18 years at 8.5 percent per annum. Total project cost: $23.5 million.

Purpose and Benefits: Fishponds and fishing vessels financed under the project would increase annual fish production by 26,000 tons, which would have an estimated value of about $11 million. In addition, the project fish carriers and ice plants would reduce operating costs and distribution losses by improving fish marketing and transportation facilities and thereby help increase productivity. The fish produced under the project would constitute an important source of protein for the Philippine population. The project would cause virtually no degradation of the environment. The estimated financial rates of return on investments vary between 17 and 39 percent, with a weighted average of 27 percent. The corresponding economic rates of return range from 21 to 43 percent, with an overall weighted average for the project of 30 percent. The project would generate 1,000 new permanent jobs required for the sub-projects and about 750 jobs resulting from the marketing of the additional fish produced under the project. Construction of project facilities would generate about 4 million man-days of employment. The project would continue to help the fisheries group (FG) further improve its appraisal and supervision procedures.

Date approved: May 25, 1976 (IBRD)

URBANIZATION: The major components of this project will respond directly to the shelter, sanitation, employment and infrastructure problems of the Tondo Foreshore and to the urban transport and institutional problems of Manila in general. The upgrading of the Tondo and the new sites and services development in Dagat-Dagatan will provide 180,000 persons in a major slum and squatter area with secure land tenure and adequate urban services, in such a manner that project beneficiaries will be able to afford to pay for these services. The traffic improvement component would focus on low-cost, high-return investments for all of Manila by providing for urgently needed traffic control measures and equipment necessary for the efficient use of existing infrastructure. The project would help strengthen two new institutions, the National Housing Authority (NHA) and the Metropolitan Manila Commission (MMC), by providing technical assistance, it would also have a formative impact on the Government's urban program because it would be its first comprehensive slum upgrading project.

Borrower: Philippines, the National Housing Authority (NHA), the Manila Water Supply and Sewerage System (MWSS), the Department of Public Works, Transportation and Communications (DPWTC) and the Department of Public Highways (DPH).

Loan: $32.0 million. The Bank loan for $22 million would be for a term of 22 years, including a grace period of 5 years and at an interest rate of 8.5 percent per annum. The Third Window loan of $10.0 million would be on standard Third Window loan terms. Total project cost: $65.0 million.

Purpose and Benefits: The provision of technical assistance to DPWTC will assist the development of metropolitan-wide management. The project will directly benefit the 180,000 persons now residing in the Tondo Foreshore area, who are among the poorest families in Manila. The current medium family income is about $576 a year which, with an average family size of 6.6 persons, is a per capita income of $87 a year. The economic rate of return for the residential component is 21 percent, and the economic rate of return for the industrial/commercial development in the project area is 40 percent.

Date approved: May 27, 1976 (IBRD)

PORTUGAL

POWER: The project will help finance the 1976–78 tranche of the electric power sector's ten-year investment program, an ambitious undertaking involving work on new generating facilities (about 3300 MW of new capacity) with related transmission and distribution facilities. The increase in generating capacity consists of hydroelectric power (48 percent), conventional thermal power (33 percent) and nuclear power (19 percent).

Borrower: Electricidade de Portugal (EdP).

Loan: $36 million; 15 years at 8.85 percent per annum. Total project cost: $1,124 million.

Purpose and Benefits: This investment program would assist in providing Portugal with ample energy to supply the industrial and domestic market growth projected for the years 1976–86. It would also permit the Electricidade de Portugal-Empresa Publica (EdP) to engage in mutually advantageous power exchanges with other European countries via the 400-kV transmission line between Portugal and Spain to be constructed as part of the project to improve the existing interconnections. As a result the Portuguese power sector will be able to install and operate large generating units economically. In addition, the internal transmission lines and associated substations included in the project will improve the transmission grid within Portugal and assist the efforts for complete rural electrification. Since the project forms only a portion of the overall 1976–1986 power expansion investment program, it was not possible to calculate the rate of return on the project in isolation from the total program. The return on the whole program was therefore estimated, using incremental revenues plus cost savings attributable to the program as an approximate measure of the benefits, and adjusting the financial costs for taxes, internal transfers and shadow pricing of unskilled labor to obtain the corresponding cost stream. Assuming rate increases used in the financial projections, which are not expected to significantly affect demand, the return would be at least 8.3 percent.

Date approved: June 22, 1976 (IBRD)

ROMANIA

AGRICULTURE: The project consists of: (a) investments in mining and industrial enterprises damaged by the 1975 floods, to replace flood-damaged machinery and spare parts, repair damaged buildings and infrastructure, reopen mines blocked by silt, and replenish damaged and lost inventories; (b) rehabilitation of 285 irrigation, drainage and flood control works which were damaged by the floods; (c) improvement of Romania's existing hydrological data system by establishing an automated flood warning system; (d) investments (in crop or livestock production) of farm enterprises which suffered losses as a result of the floods in excess of 20 percent of their respective annual production planned for 1975; (e) reconstruction of flood-damaged transport works consisting of about 120 km of national highways, including 18 bridges, and 270 km of railroads, including 20 bridges.

Borrower: Investment Bank and Bank for Agriculture and Food Industry (BAFI).

Loan: $60.0 million; 20 years at 8.5 percent. Total project cost is $345 million.

Purpose and Benefits: The Flood Recovery Project will provide critically needed support to Romania's immediate efforts to recover from the serious dislocations of recent floods. The industrial component of the project will restore production and eliminate bottlenecks which, if uncorrected, would cause even greater production losses than have already occurred. The project would also help seriously damaged farms recover from the floods and would repair damaged flood protection, irrigation, and drainage works before the next flood and agricultural seasons in the spring of 1976. For the longer-term, the project would provide the specialized equipment necessary both for data collection and for early warning of future floods. The transportation component would provide for permanent repair of the national road and rail systems. Becouse of the diverse nature of the project, it has not been possible to calculate an economic rate of return. However, given the high sunk costs of facilities which cannot now be fully utilized and the high incremental benefits of putting these facilities back into use, industrial and transport rehabilitation would have an extremely high return.

Date approved: November 4, 1975 (IBRD)

POWER: The project comprises construction of: (a) a reservoir (Gura Apelor) to be formed by a clay-cored, rock-fill dam, Tomeasa, 173 m high across the valley of the Riul Mare in the neighborhood of Mount Retezat from which the project takes its name. A high pressure tunnel 18.4-km long conveys the reservoir releases to the Retezat underground power plant of 335 MW having two units working with a gross head of 583 m. The tailrace of Retezat is also the headrace of the above-ground 14-MW powerhouse, Clopotiva, which uses a head of 25 m. There are 25 secondary intakes which collect water from adjacent streams and drop it into the pressure tunnel or convey it through a tunnel 34 km long to Gura Apelor reservoir; (b) transmission lines at 110 kV will interconnect the Retezat-Clopotiva power stations and 220-kV lines will connect the Retezat power stations with the existing system at Burul Mare; (c) roadworks needed for the execution of the project are now available.

Borrower: Investment Bank, Romania; Hatzeg Generating Enterprise.

Loan: $50.0 million; 20 years at 8.5 percent per annum. Total project cost is $250 million.

Purpose and Benefits: The Riul Mare Project (349 MW) is expected to be completed in 1983 and, with its associated downstream development, is the least-cost alternative from available schemes to provide 400 MW by 1985. Aside from the output of electric power, other benefits are associated with the project. River regulation will provide a perennially secure flow in the Riul Mare and Stri rivers, the Gura Apelor reservoir recreational benefits and road works which by extension beyond the project area will serve to improve communications. Such benefits are judged to be relatively small and would not materially influence the project's justification.

Date approved: April 13, 1976 (IBRD)

AGRICULTURE: The project consists of an irrigation system for 65,400 hectares and related agricultural investments. The irrigation component consists of: (a) five main supply pumping stations and four secondary stations; (b) about 170 km of concrete-lined main, branch and distributary canals; (c) 39 pressure pumping stations to provide pressure to water entering about 1,570 km of buried distribution pipelines; (d) about 240 km of 20 KV power transmission lines with transformer substations having an aggregate capacity of 137 MVA; (e) portable irrigation equipment, operation and maintenance equipment, and farm machinery and implements; and (f) land leveling works, on about 13,000 ha and erosion control works on about 7,000 ha.

Borrower: Bank for Agriculture and Food Industry of Romania.

Loan: $60.0 million; 20 years, including 5-year grace period, interest at 8.5 percent per annum. Total project cost: $141.3 million.

Purpose and Benefits: The project will contribute to Romania's overall effort to increase and stabilize agricultural production through investment in irrigation and related farm development. Without the project, production under rainfed agriculture could be expected to fluctuate by as much as 20 percent from year to year with an annual average gross production of about US$8.5 million, and the project area could be expected to remain a relatively undeveloped region of the country. The project is expected to increase the gross value output to a relatively stable US$32.5 million annually, an increase of 280 percent. Six thousand members of cooperatives and their families, totaling 13,000 people, would be the principal beneficiaries of the project. The economic rate of return of the project as a whole is estimated at 17.4 percent.

Date approved: April 27, 1976 (IBRD)

SENEGAL

AGRICULTURE: During its four-year implementation period 1976–79, the project would: (a) establish nine new villages for 450 settler families, and install 150 families in existing villages; (b) construct eight settlement officer houses, nine stores, 12 classrooms, 76 km of village access tracks and 25 km of secondary roads; (c) construct nine wells for new villages and rehabilitate about 15 wells for existing villages accepting settlers; (d) provide settlers with tools and grants for manual land clearing, subsistence allowances, and credit facilities for agricultural inputs and mechanical land clearing; (e) provide farm extension services; and (f) provide the staff and consultant services required to prepare a regional plan, and investment proposals for the development of the agricultural sector in Eastern Senegal.

Borrower: Republic of Senegal.

Loan: \$2.0 million; 50 years at 0.75 percent per annum. Total project cost: \$3.9 million.

Purpose and Benefits: The project will continue settlement in an area of some 900 km² in, and adjacent to, the pilot project area, and prepare a master plan for the region, including investment proposals for an integrated regional agricultural development project. Without the possibility of migration offered by the project, many settlers would have been landless and dependent on relatives and friends for their subsistence. For these settlers the project will provide otherwise unobtainable income opportunities. The net value of farm production, including the food consumed by the family, would rise from about \$400 to about \$1,300 between Year 1 and Year 10 due to the participation of families moving to new villages, and from \$300 to about \$1,100 for those families moving to existing villages. During the same period, settler families are expected to increase from 5 to 10 members, mainly as a result of continued migration of relatives from the departure area and consequently per capita incomes are expected to increase from about \$80 to about \$130 and from about \$70 to about \$110, respectively. Prior to their departure, the per capita incomes of settlers would mostly be amongst the lowest 25 percent of the rural population and would be between \$30 and \$70. Hence the project would provide settlers with adequate financial incentives. The project would increase the annual output of seed cotton by 1,500 tons, of unshelled groundnuts by 2,800 tons, and of cereals by 3,500 tons. It would improve the livelihood of 6,000 members of settler families, and would contribute about CFAF 300 million (US\$1.3 million) net annually to Senegal's foreign exchange earnings. The project roads, water supply and social infrastructure improvements would also benefit about 10,000 members of existing farm families in the project area. The economic rate of return is estimated to be 14 percent.

Date approved: July 8, 1975 (IDA)

TRANSPORTATION: These funds will help finance the improvement and subsequent maintenance of about 1,000 km of feeder roads and maintenance of about 250 km of existing feeder roads; purchase of highway equipment and spare parts and of materials and supplies for project operations; and technical assistance for project implementation and monitoring.

Borrower: Republic of Senegal, Ministry of Public Works, Urban Development and Transport (MPWUT).

Loan: \$6.6 million; 25 years at 4.5 percent per annum. Total project cost: \$8.5 million.

Purpose and Benefits: The economic justification for the project rests on two types of benefits from road improvement and subsequent maintenance: (i) savings in total transport costs; and (ii) increased transport reliability and, in some cases, provision of access to possible markets. The economic rate of return of the whole project would be about 14 percent. The rate of return is considered conservative as benefits from other than the main agricultural crops are not taken into consideration, and the assumption of 4 percent traffic growth may be low since most feeder roads to be improved are located in areas with ongoing or future agricultural development programs.

Date approved: March 16, 1976 (IBRD)

TRANSPORTATION: This loan will help provide funds for pavement strengthening of 204 km of primary roads; purchase of equipment for highway maintenance and for soils laboratory and Directorate of Studies and Programming (DSP); technical assistance for the promotion of the domestic construction industry and for transport planning; consulting services for project supervision, including road maintenance begun under the Second Highway Project, and for preinvestment studies for a further 260 km of roads.

Borrower: Republic of Senegal, Ministry of Public Works, Urban Development and Transport (MPWUT).

Loan: \$15.0 million; 20 years at 8.5 percent per annum. Total project cost: \$24.0 million.

Purpose and Benefits: The primary purpose of this project is to protect past investments by rehabilitating and maintaining the existing highway network. Benefits from road improvement will primarily result in cheaper, safer and more reliable transport and in savings in road maintenance costs. On the basis of conservative traffic projections, and savings on vehicles operating costs alone, the economic return on the pavement strengthening component, which accounts for 80 percent of project cost, is estimated at 30 percent with returns for individual sections ranging between 22 and 42 percent. With regard to the highway maintenance component, which accounts for eight percent of project cost, the program started under the Second Highway Project, is now estimated to have an economic return of 28 percent. The economic return for the whole project is about 30 percent.

Date approved: March 16, 1976 (IBRD)

AGRICULTURE: This project will be carried out over the five-year period, mid-1976 mid-1981, and includes: (a) developing and operating a grazing scheme on about 1.4 million ha of understocked grazing land in the northern part of Eastern Senegal, involving principally: (i) organizing some 6,500 predominantly pastoralist families into about 65 grazing units to whom exclusive rights to land and watering facilities would be granted; (ii) constructing wells and firebreaks; (iii) granting credit to herders for the purchase of breeding animals, and small farm equipment; (b) improving animal health services throughout Eastern Senegal; and (c) providing fellowships and training.

Borrower: Republic of Senegal.

Loan: \$4.2 million; 50 years at 0.75 percent per annum. Total project cost: \$13 million.

Purpose and Benefits: The principal direct benefits from the project would be incremental annual livestock production worth \$3.0 million in 1975 terms. Each of the 6,500 pastoral families benefiting from the grazing scheme is expected to nearly double its average annual cash income from livestock production to $670, while some 24,000 other rural families benefiting only from the improved animal health services, would increase theirs from $250 to $310. In addition, about 1,000 seasonal and 80 permanent jobs would be created. The overall economic rate of return of the project is estimated at 23 percent. The degree of risk involved in the grazing scheme appears acceptable given the generally successful results of similar grazing schemes in East Africa. Such schemes also appear to offer the only practical means to achieve significantly better use of the livestock, pasture and human resources of the area and, at the same time, to prevent environmental degradation through overgrazing. Moreover, an appropriate legal framework is provided to protect the grazing units from encroachment; and, most importantly, the potential benefits to pastoralists from participation are very attractive.

Date approved: June 3, 1976 (IDA)

AGRICULTURE: This project will encourage farmers in the Sedhiou district of Casamance to adopt improved crop and livestock production techniques by supplying them with inputs, credit and technical assistance. The project would carry the 4,150 farm families already participating in the first project to higher levels of technology and induce 3,250 farm families now using traditional farming methods to adopt the improved cropping techniques which have proved effective under the first project. In addition the project would encourage 4,800 families from both groups to take up better livestock practices. It would also help strengthen cooperatives by management training and by promoting the organization of cooperative unions.

Borrower: Republic of Senegal.

Loan: U.S. $6.3 million; 50 years at 0.75 percent per annum. Total project cost: $14.9 million.

Purpose and Benefits: The project's direct benefits would be increases in output of groundnuts, cereals, cotton and livestock products. The economic rate of return of the project would be 23% over 15 years. The project is expected, to bring a satisfactory return to the Senegalese economy. In addition to the directly quantifiable benefits derived from increased production, the project would help organize cooperatives to deal effectively with the procurement and distribution of farm inputs, marketing of cereals and processing of paddy. It would also strengthen management and organization of the new regional agency and identify rural development possibilities in Casamance.

Date approved: June 22, 1976 (IDA)

SIERRA LEONE

EDUCATION: (a) *Secondary level education:* (i) Construction and/or equipment for introducing practical instruction in 19 existing secondary schools, including complementary works at six first project schools and staff houses; (ii) construction, equipment and fellowships for a technical teacher training program at a secondary teacher college; and (iii) construction and equipment for three trade schools. (b) *Rural and non-formal training:* (i) A pilot studies fund to help broaden the educational base, to develop rurally oriented, non-formal vocational training and to strengthen the use of radio and support materials to reach youths and adults in rural areas; and (ii) construction, equipment, specialist services and fellowships to assist the Ministry of Social Welfare National Training Center in undertaking experimental programs for improving the training of rural development personnel. (c) *Educational planning, management and management training:* (i) Construction, equipment, and fellowships for the planning unit of the Ministry of Education; (ii) specialist services for establishing a University of Sierra Leone Development Plan; and fellowships for the Institute of Education and five regional instructional resource centers; and (iv) construction, equipment, specialist services and fellowships for establishing an Institute of Public Administration. (d) *Project Administration:* Staffing and equipment expenditures for project administration.

Borrower: Republic of Sierra Leone.

Loan: $7.25 million; 50 years at 0.75 percent per annum. Total project cost: $11.0 million.

Purpose and Benefits: This second education project will help create a closer link between the education system and the employment requirements of the country by introducing more relevant instruction at secondary and trade schools and by establishing a technical teacher training program for secondary schools. It will also support research and experimentation required to better adapt the existing educational system to the rural environment and to find ways, at minimum cost and most likely through non-formal approaches, of extending the benefits of this system to a larger share of the rural population, including adults. The project will also assist in improving the training of rural development workers under the Ministry of Social Welfare, and it will help to strengthen the Government's administrative and planning mechanisms to achieve its educational and training objectives through: assistance to the planning efforts of the Ministry of Education planning unit, the University of Sierra Leone administration and the Institute of Education; and through the establishment of an Institute of Public Administration and Management for training private and public sector managers.

Date approved: July 22, 1975 (IDA)

SOMALIA

TRANSPORTATION: The project will enlarge the present port of Mogadiscio and includes: (i) construction of a 180-meter long and 12-meter deep general cargo berth in line with the two 160-meter long and 10-meter deep general cargo berths financed under Credit 359-SO; (ii) construction of a 180-meter straight line extension of the present 770-meter breakwater; and (iii) supervision of construction as well as provision of study and design services for a slipway, lighter and tug berths.

Borrower: Somali Democratic Republic, The Somali Port Authority (SPA).

Loan: $5.2 million; 50 years at 0.75 percent. Total project cost: $6.45 million.

Purpose and Benefits: The benefits from a third general cargo berth will consist of reduced waiting time for ships served by the new deepwater berths, reduced cargo damages and losses, and elimination of surcharges imposed by shipping lines for lighterage operations. The cost reduction for the proposed three-berth alternative as compared to two berths has been calculated at US$0.7 million in 1977 yielding a first year economic return of 12 percent which confirms appropriate timing of the investment. The economic return of the project over a 30-year lifetime is estimated at 20 percent, the annual cost reduction increasing with the expansion of traffic volume through the port and reaching some US$1.5 million in

SOMALIA (Continued)

1980. A fourth berth will be needed by the early 1980's, according to present traffic forecasts.

Date approved: September 23, 1975 (IDA)

AGRICULTURE: This project will help develop 9,000 ha in Dujuma and 3,000 each in Sablale and Kurtum Warey Settlement over a three-year period and includes provision for: (a) 25 crawler tractors for bush clearing on 15,000 ha; (b) 100 tractors with attachment to be used for ploughing and cultivation as well as for transport within the settlements; (c) 8 four-wheel drive vehicles; (d) 6 mobile workshops and 3 office buildings; (e) local staff; (f) project monitoring, evaluation and preparation; and (g) technical assistance.

Borrower: Somalia, National Rehabilitation Committee.

Loan: $8.0 million; 50 years at 0.75 percent per annum. Total project cost: $62.3 million.

Purpose and Benefits: The project will support the development of 15,000 ha of start-up crop production within the three newly established settlements in the Juba-Shebelli area in the southern part of Somalia. It forms part of an emergency agricultural settlement project supported by IDA, the Arab Fund for Economic and Social Development (Arab Fund), and the African Development Fund. The Arab Fund would provide support for the development of 15,000 ha of irrigated cultivation and the African Development Fund would assist in the establishment of three hospitals for settlement populations. Alternative income-earning opportunities for the destitute nomads from the North are to be found only in the southern settlement areas, and the problem should be viewed in the context of the fact that Government would have to continue to feed, house and clothe the settlers. In the case of the rainfed part of the Settlement Scheme which is proposed for IDA financing, the elaboration of a long-term agricultural development strategy depends on experience gained in the implementation of the project and the outcome of further studies, which will be carried out as part of the project.

Date approved: April 13, 1976 (IDA)

AGRICULTURE: The project seeks to assist in the redevelopment of the North-West Region through soil and water conservation, and other measures to increase agricultural production; to support current trend toward settled agriculture; and to provide technical basis for preparation of future projects. It consists of: (a) Construction of field bunds on 25,000 ha, repair of existing bunds on about 2,000 ha and experimental gully erosion control works; (b) development of 50 small irrigated farms; (c) extension of the Geed-Deeble irrigated horticultural station for fruit crop trails, nursery production and sorghum seed multiplication; (d) rehabilitation of the extension service to dryland farmers and establishment of a new extension section serving irrigated farms; (e) construction of water points for human consumption and for livestock; and (f) technical services, training and feasibility studies.

Borrower: Somali Democratic Republic.

Loan: $10 million; 50 years at 0.75 percent per annum. Total project cost: $13.2 million.

Purpose and Benefits: The internal economic rate of return of the project is estimated at about 11% over 25 years. The major quantifiable benefits arising from the project would be increased production of sorghum, fruits and vegetables, which at full development (Year 13) would be valued at $0.75 million. Sorghum would be consumed in the region while about 35–50% of fruits and vegetables would be exported. The project would also reduce the necessity of costly internal transfers of foodgrains at a significant saving to the Somali economy, and would help to narrow the income disparities between the northern and southern regions of the country.

The project would result in additional employment for an estimated 500 persons in the construction of the field bunding and it would also help to reduce underutilization of family labor on participating farms. There would be substantial increase in the cash incomes of approximately 2,500 families, almost all of whom are now living at subsistence levels. Per capita annual net incomes would be raised from approximately $46 without the project, to about $80 with the project. Furthermore, a sizeable number of nomadic people would use some of the facilities created by the project, particularly the water points for livestock. The improved seed and better agricultural services which will be provided by the project, as well as the feasibility studies, would gradually increase yields and help develop an optimum technological package which would improve the financial and economic basis of subsequent projects in the North-West area and in the Southern Bay Region.

Date approved: June 3, 1976 (IDA)

SRI LANKA

AGRICULTURE: The project is aimed at supporting both the food and tree crop sub-sectors. IDA funds would finance imported farm tractors, machinery, equipment and transport vehicles ($18.0 million), and spare parts for farm tractors, earth-moving equipment and the coconut processing industry ($6.5 million). Technical assistance would also be provided for preinvestment studies and for improvements in machinery repair facilities ($0.5 million).

Borrower: Republic of Sri Lanka, Ministry of Agriculture.

Loan: $25 million; 50 years at 0.75 percent. Total project cost: $60.5 million.

Purpose and Benefits: The project is designed to support on-going priority agricultural rehabilitation and development programs through the provision of imported capital equipment and technical assistance. The support provided would increase agricultural production in the short-term and lay the foundation for longer-term, more comprehensive, development. The support to the food crop subsector would result in an estimated increase in production from the sixth year of the project of 155,000 tons of rice, 15,000 tons of cereals and pulses, and 11,500 tons of sugar. Quantitatively, this incremental production is equivalent to over 40 percent of total current rice imports and to 20 percent of the recent, sharply-reduced sugar imports. Additional production increases could be expected through the improved activities of the Department of Agriculture, particularly the extension services. Measuring the incremental benefits which would arise out of the support for the tree crops subsector is difficult, but it would primarily help maintain the quality of the end-products by reducing the deterioration of the raw material during transport from field to factory. The support to the estate sector would also result in greater assurance of employment for tea pluckers and rubber tappers, the poorest segment of Sri Lanka's rural population. Transport for the bought-leaf factories would be provided to smallholder tea producers, assisting the majority of the approximately 115,000 smallholder tea producers, and complementing the proposed improvement in extension activities. The existence of high sunk costs in relation to incremental investment would lead to an unusually high rate of return and, due to the nature of the project, no rate of return has been calculated. The project would also assist in one form or another the vast majority of smallholder paddy producers in the Dry Zone. The number of beneficiaries would be around 320,000 farm families or about 13 percent of the total population of Sri Lanka.

Date approved: December 11, 1975 (IDA)

SUDAN

DEVELOPMENT FINANCE COMPANY: The credit would help meet part of the Industrial Bank of Sudan's (IBS) estimated commitments of foreign exchange for financing the import component of subprojects to mid-1977. The IBS' foreign currency resource gap for the period 1975 to mid-1977 is estimated to be about $14 million. IBS is expected to receive about $2.1 million (equivalent) from the 1976 German capital assistance loan to Sudan, and a credit of $5 million from the Kuwait Fund. The increase of LSd0.5 million in IBS's capital proposed by the Bank of Sudan, together with net cash generation, will provide an adequate supply of local currency resources for the next few years.

Borrower: The Democratic Republic of the Sudan, Industrial Bank of Sudan (IBS).

Loan: $7 million, 15 years at 8 percent.

Purpose and Benefits: The Government's plans for investment in the public sector, together with the incentives offered to foreign and domestic private investors have generated an improved investment climate in Sudan. The demand for foreign exchange by small and medium-sized industrialists is considerable. These demands are unlikely to be met on appropriate terms from supplier credits and no other institution in Sudan is catering adequately to their needs. In addition to meeting these needs, the IBS can help the government to meet its objective of diversifying exports (vegetable oils, sugar and textiles) and substituting domestic production based on domestically produced raw materials for imports (textiles and building materials). This diversification would release scarce foreign exchange for imports of capital goods and raw materials not produced domestically. The application of appropriate methods of economic appraisal to IBS projects will provide useful knowledge to the Government indicating the appropriateness of specific industrial policies applied in Sudan.

Date approved: October 28, 1975 (IDA)

TECHNICAL ASSISTANCE: This is a three year program to help finance studies leading to high-priority investment in the economy and to expand the capacity of Sudanese institutions to manage preinvestment work.

Borrower: The Democratic Republic of the Sudan.

Loan: $4.0 million; 50 years at 0.75 percent per annum. Total project cost: $8.5 million.

Purpose and Benefits: Constraints on an expanded investment program include remaining transportation deficiencies, and the capacity of the construction industry, as well as the capacity of the various government agencies to manage a larger program. For investment to continue to expand, Sudan needs to deal with all these constraints, and it also needs to expand its capacity to identify projects for financing and its ability to manage the preinvestment work which is a prerequisite to a commitment of investment funds. While some work of this kind is being undertaken, the Government considers, and IDA agrees with this view, that the absence of a sufficient flow of adequately prepared projects has become a major barrier to the maintenance and further expansion of the level of investment.

Date approved: February 17, 1976 (IDA)

TRANSPORTATION: The project includes the construction of two new airports, improvement of two airports, purchase and installation of communications, navigational and maintenance equipment, and technical assistance and training for the Civil Aviation Department.

Borrower: The Democratic Republic of the Sudan, Civil Aviation Department (CAD).

Loan: $29.0 million. (The loan ($20 million) would be for 25 years, at 4.85 percent. The credit ($9 million) would be for 50 years, at 0.75 percent per annum.) Total project cost: $86.2 million.

Purpose and Benefits: The case for financing air transport in the Sudan rests on the extremely low density of the road network, the physical constraints on rail and river transport and the very large size of the country. For many years to come, air transport can offer not only speed and the lowest costs on many routes for passengers and selected freight commodities, but in many cases the only practical means of travel. The cost of creating alternative ground systems of transportation would be prohibitive in the short term. The major sources of quantifiable benefits of the project would be the much lower operating costs of more efficient, jet aircraft which the project would permit, compared with the existing propeller-driven aircraft; the higher utilization of aircraft which would be facilitated by the installation of night landing aids, and the increased revenues which will accrue when Sudan can offer adequate services to overflying aircraft. Passenger time savings could be counted, but these are marginal to the project's economic justification. Unquantified benefits include elimination of the current excessive waiting time, due to the inadequate capacity of the existing aircraft; and improved marketability of high value commodities produced in the Southern Region resulting from decreased transport costs and the extra capacity which would be created. The economic costs of the project exclude about $3.8 million of investment which are necessary merely to permit the current services to continue in reasonable safety. Excluding passenger time savings, the estimated economic return for the total project would be 18 percent. For the three southern airports the return would be 15 percent and for Port Sudan 22 percent. For airport lighting and navigational aids the return would be 16 percent.

Date approved: June 15, 1976 (IBRD and IDA)

SYRIA

WATER SUPPLY: This project includes: (i) an underground dam to capture the flow of the source (Figeh Spring); (ii) a pumping station at the Figeh Spring to increase season flows; (iii) a tunnel 15 kilometers in length from the spring to the principal storage reservoirs of Damascus; (iv) a principal storage reservoir (underground) at Wali with a capacity of 60,000 m^3; (v) distribution system reservoirs with a combined capacity of 44,800 m^3; (vi) a new pumping station and renovation of existing pumping stations; (vii) a telecommunication system for data transmission, water flow control and leak detection; (viii) engineering services for design and supervision; and (ix) training of the Etablissement

SYRIA (Continued)

Public des Eaux de Figeh (EPEF) staff and technical assistance to EPEF.

Borrower: Syrian Arab Republic, Etablissement Public des Eaux de Figeh (EPEF).

Loan: $35 million; 25 years at 8.5 percent per annum. Total project cost: $137 million.

Purpose and Benefits: This project, together with related projects forming the Damascus five-year water supply investment program, is the first major expansion of the city's water supply and distribution system in more than 40 years; it is unavoidable if Damascus is to avert serious water shortages and related health hazards as well as serious constraints in the city's expansion and in the improvement of its inhabitants' living conditions. The major elements of the program represent the least cost solution, chosen from among several alternatives. The economic benefits of the project cannot be separated from those of the remainder of the program of works required to meet the needs of Damascus. Using incremental water supply revenues from the investment program as a minimal measure of economic benefits, on the basis of the charges the consumers are currently (1975) paying for water, the program has a negative internal economic return (about –2 percent). This calculation merely demonstrates the total inadequacy of present tariffs relative to the very high costs of EPEF's expansion. On the basis of revenues derived from the first tariff increase, the internal economic return would rise to 3 percent; it has been calculated that the return would rise to 8.5 percent on the basis of revenues derived from subsequent tariff increases as required in keeping with the provisions of the cash generation covenant. In the long run, the tariff would thus approach the average incremental cost of water.

Date approved: April 13, 1976 (IBRD)

TELECOMMUNICATIONS: This project consists of the following urgent works in the Syrian telecommunications program during 1976–78 and constitutes a balanced and integrated package: (a) Installation of about 75,000 automatic telephone connections; (b) installation of about 12,000 manual telephone connections; (c) provision of telephone access to about 540 villages; (d) expansion of long distance facilities with the: (i) installation of the Damascus-Aleppo-Latakia-Palmyra coaxial cable system and the Homs-Raqqa-Deir-ez-zor-Hassake microwave system, (ii) replacement of the obsolete Damascus-Aleppo-Latakia-Raqqa microwave system; (iii) installation of a microwave/UHF systems on spur routes comprising Damascus-Tanf, Homs-Palmyra via Khenefis, Homs-Tartous, Hama-Banias, Tartous-Latakia, Jable-Kerdaha, Latakia-Kessa, Aleppo-Djerablous, Raqqa-Tall Abiad, Hassake-Ras al Ain, Hassake-Oamishliye, and Deir-ez-zor-Abou Kemal. (e) Completion of installation of automatic trunk exchanges with 2,800 lines; (f) installation of about 300 teleprinters for the telegraph and telex services; (g) expansion of the international facilities with installation on an earth station working via the Indian Ocean satellite; (h) provision of an international telephone switching center for about 800 lines; and (i) establishment of a new telecommunications training center in Damascus.

Borrower: Syrian Telecommunication Establishment (STE).

Loan: $28 million, 20 years at 8.5 percent per annum. Total project cost: $145.6 million.

Purpose and Benefits: According to STE's conservative forecasts, by the end of the development plan period 1980, about 86 percent of total expressed demand will be satisfied in urban areas and 100 percent in rural areas, as compared to the 1974 level of about 48 percent in urban and 57 percent in rural areas. The waiting list would be reduced to about 59,000. Waiting time for new connections now about seven years on average will decrease somewhat at the end of the project in 1978, but the waiting time will be reduced to less than two years only by the end of the Plan period in 1980. The expansion will establish reliable communications with new economic development areas such as the Lower Euphrates Valley and the phosphate producing region south of Palmyra and improve telecommunications between the coastal cities. In addition, this extension of Syria's long distance services will result in better quality, speed capacity for new intraregional and international communications through Syria, particularly with Iraq and the Gulf States and Egypt. The internal rate of return on the project is estimated to be 20.6 percent.

Date approved: May 20, 1976 (IBRD)

TANZANIA

AGRICULTURE: The project comprises rehabiliation and expansion of commercial dairy farming on parastatal farms, improvement of milk collection, processing, and distribution facilities, development of the traditional dairy sector in 50 ujamaa villages, breeding improved dairy heifers, technical services and applied investigational work for animal disease control, and future project preparation.

Borrower: United Republic of Tanzania.

Loan: $10.0 million; 50 years at 0.75 percent per annum. Total project cost: $15.3 million.

Purpose and Benefits: The benefits of the project consist of increased production of milk and high grade dairy heifers, which will result in savings of foreign exchange by reducing dairy imports and increased milk consumption in villages where nutritional levels are low. Annual foreign exchange savings of about $2.7 million are anticipated when the project is fully developed. Ujamaa villages participating in the project would derive benefits either in the form of increased milk for consumption (and thus improved levels of nutrition) or its equivalent value as cash revenue, estimated at $3,000 per village annually at full development and $2,000 annually from livestock sales. The economic rate of return from the project is estimated to be 22 percent over 25 years. An increase in total project costs of 10 percent would lower the return to 18 percent; a decrease in project benefits of 10 percent would also lower the return to 19 percent. The primary risk involved in this project is the sensitivity of dairy output to the quality of farm management. For the parastatal farms to remain viable, the quality of farm management would have to be improved through the technical assistance that would be provided by this credit. The ujamaa dairies involve high risk since there is little experience with this dairy model. This experiment, however, is low in cost ($0.5 million) and holds promise as the beginning of a large program of dairy development through developing high yielding dairy methods and a cadre of skilled manpower.

Date approved: July 1, 1975 (IDA)

DEVELOPMENT FINANCE COMPANY: The Tanzanian Investment Bank (TIB) was established in 1970 to provide medium- and long-term financing for industrial development, including agricultural processing and tourism. By statute, TIB's share capital must be owned proportionately by the Government (60 percent), the National Bank of Commerce (30 percent), and the National Insurance Company (10 percent)—the latter institutions both being wholly owned by the Government. TIB's operations have increased sharply and its financing now accounts for about 20 percent of new investments in the manufacturing sector of Tanzania. Its pipeline of projects is well conceived and covers various sub-sectors. To cover projected commitments until December 31, 1977, TIB needs $66.5 million in new resources, including $38 million in foreign exchange. Taking into account likely contributions from other sources, TIB has a foreign resource gap of $15 million to cover the import component of its projected commitments until December 31, 1977.

Borrower: Tanzania Investment Bank (TIB).

Loan: $15 million, repayable substantially in conformity with the aggregate of the amortization schedules for subloans, at 8.5 percent per annum.

Purpose and Benefits: The objectives of the loan for TIB are twofold. First, in line with the Government's plan to reduce Tanzania's economic dependence by increasing productive investments, the loan will provide resources for investment in medium and large-scale industries, agro-business and tourism. Second, the loan will make it possible to support TIB in further improving its procedures and project selection. TIB's business prospects are good as many promising investment opportunities in the industrial sector exist. The three most important sub-sectors were food and food processing (30 percent); wood and wood processing (13 percent); and tanneries and leather processing (10 percent). The average estimated financial rate of return on subloans is 19 percent and the economic rate of return 31 percent. Forty percent of TIB's approvals were in the agro-industry sector, a response to the Government's efforts to increase food production.

Date approved: October 28, 1975 (IBRD)

TECHNICAL ASSISTANCE: The project would comprise: (a) about 80 man-years of consulting services to: (i) prepare pre-investment studies and feasibility studies for high-priority productive investments mainly, but not exclusively, in the industrial, mining, transport and communications sectors, and (ii) conduct special studies at the sector and firm level; (b) overseas training for Tanzanians in project preparation, evaluation, implementation and related techniques; and (c) a project unit and related supporting services. It is expected that the project would be completed in about four years.

Borrower: United Republic of Tanzania.

Loan: $6.0 million; total cost is $7.5 million, 50 years at 0.75 percent.

Purpose and Benefits: The project will assist the Government in implementing its program of economic restructuring and efforts to shift the emphasis of the country's investment programs from infrastructure to more directly productive projects. The special studies designed to improve the utilization of existing production facilities could result in significant short- and long-term increases in output. The project has been deliberately designed to be flexible so as to meet Tanzania's changing needs for pre-investment and special studies. However, this in turn places considerable responsibility on the Project Implementation Unit, whose role in identifying and preparing suitable sub-projects and following up financing for viable projects which emerge from the studies will be crucial.

Date approved: November 25, 1975 (IDA)

AGRICULTURE: These funds will finance maize production inputs to approximately 950 participating villages; the strengthening of extension services through training and the provision of transport and extension aids; the improvement of maize research; assistance for further project preparation; and the provision of related technical services.

Borrower: United Republic of Tanzania, Tanzania Rural Development Bank (TRDB).

Loan: $18 million; 50 years at 0.75 percent per annum. Total project cost: $38.1 million.

Purpose and Benefits: The project would increase maize production by about 20,000 tons in year one, rising to about 195,000 tons annually at full development in 1982. This level should be sufficient for Tanzania to attain self-sufficiency in an average year and would imply annual net foreign exchange savings of about $10 million. During the project period the Government plans to establish a national maize reserve of about 90,000 tons and any project production in excess of requirements would be channeled into this reserve. Estimated increases in average annual cash incomes of participating farm families would amount to about 20 percent or $32. The project's internal rate of economic return is estimated at 37 percent. The project is also expected to have positive ecological effects.

Date approved: December 23, 1975 (IDA)

EDUCATION: The project would assist the Government to implement its education development program as follows: (1) *Support of the rural training program*—operational costs, building materials for about 1,500 houses, equipment, 2,000 bicycles, 500 motorcycles, and other vehicles for a rural training program together with related equipment and furniture for five rural training centers involved; (2) *Extension of the secondary school system*—equipment for, improvements to and rebuilding of, where required, 15 secondary schools, and (3) *Provision of Technical Assistance*—the cost of specialists' services for: the National Board of Accountants and Auditors, the Project Unit of the Ministry of National Education, a survey of secondary school and a review of the content and delivery system for primary education for the Ministry of National Education.

Borrower: United Republic of Tanzania.

Loan: $11.0 million; 50 years at 0.75 percent per annum. Total project cost: $15.1 million.

Purpose and Benefits: The project is the fifth IDA credit for education in Tanzania. It includes three elements in support of Tanzania's educational policy: (a) a program for the development of personnel necessary to organize and administer the cooperative villages; (b) continuation of the improvement of secondary education started immediately after independence; and (c) provision of specialists' services for accountancy and financial training, to survey the secondary school system, to review the content and delivery system of primary education, and to implement this project. The rural training component of the project is the first phase of a broad long-range program directed at meeting these needs. Under this component training will be provided for the existing field staff of cooperative inspectors and community development workers in village management and they will be supplied with the essential facilities they need to operate effectively in the villages. The secondary school component will provide for the expansion of secondary schools and represents a continuation of IDA's long in-

TANZANIA—Continued

volvement in the development of Tanzania's secondary school system. Together with parallel investments financed by bilateral agencies, this project would enable most of Tanzania's secondary schools to provide a balanced curriculum including scientific and practical subjects. This would ensure that graduates are adequately prepared for entry into the local labor market or for further education in the scientific, technical and medical fields.

Date approved: December 30, 1975 (IDA)

THAILAND

AGRICULTURE: The loan funds will provide irrigation facilities for 97,000 ha on the west bank of the Nan river consisting of a diversion dam about 30 km north of the city of Phitsanulok; a main, lateral and sub-lateral canal system and service roads; flood control works and drains; on-farm development; necessary agricultural supporting services including extension, research, seed multiplication, credit; a fisheries development scheme; annual surveys of water-associated diseases; buildings, equipment and vehicles; water resources studies of the Chao Phya and Mekong Basins; feasibility studies to prepare further irrigation projects and a second stage project on the east bank of the Nan river; administration and organization studies related to irrigated agriculture.

Borrower: Thailand, Ministry of Agriculture and Cooperatives.

Loan: $95 million; 30 years at 8.5 percent. Total project cost: $148 million.

Purpose and Benefits: The project would make a significant contribution towards meeting the Government's objective of increasing rice yields and cropping intensities as well as promoting crop diversification. It would make better use of past investments in irrigation by utilizing water stored by the Sirikit dam. It would raise the income level of the rural population and generate new employment opportunities in the southern part of Northern Thailand, in line with the regional objectives of Government economic policy. Through the provision of perennial irrigation, on-farm development and supporting agricultural services, it would result in a considerable increase in cropping intensity and yields of rice and a wide variety of other crops in an area currently under rainfed subsistence farming. The project would also generate significant employment opportunities. While at present the area provides the equivalent of 14,500 jobs a year in agriculture, the number is expected to increase to about 57,000 at full development. In addition, there would also be a significant increase in employment opportunities in the services sector. The annual gross value of production is expected to reach $70 million at full development, 14 years after project initiation, as compared with a current level of $20 million. Using adjusted border prices, the incremental economic benefits would be $35 million per annum at full development, giving an economic rate of return of about 20%. This analysis does not account for substantial secondary benefits from facilities to be constructed under the project (e.g., an improved transportation network), benefits from livestock production or returns from crops such as cotton and sugar, which might be introduced and which are more profitable than those presently included in the cropping pattern.

Date approved: July 15, 1975 (IBRD)

AGRICULTURE: The project will improve access to isolated villages by constructing about 1,300 km of village access roads and improving maintenance on about 2,000 km of existing feeder roads. The project will also improve village water supplies through construction of about 4,000 tubewells and the construction or rehabilitation of small dams and ponds; the electrification of 346 rural villages; the strengthening of upland crop research and the expansion of agricultural extension services; the study of land settlement areas and the undertaking of selected infrastructure improvements.

Borrower: Kingdom of Thailand, Ministry of Interior, Ministry of Agriculture and Cooperatives, and Provincial Electricity Authority.

Loan: $21.0 million; 25 years at 4.5 percent. Total project cost: $45 million.

Purpose and Benefits: The village access roads, village water supplies and rural electrification included in the project would directly benefit some 400,000 farm families, or about 2.5 million people, whose incomes and living standards are among the lowest in Thailand. The upland crop improvement program would aim at solving the most pressing agricultural problems of the region; namely, the loss of soil structure and fertility and decline in yields caused by continuous cultivation of kenaf and cassava, the main cash crops in the Northeast. Finally, the establishment of a more effective extension system in four provinces, involving the recruitment and training of progressive farmers, would serve as a model for extending the system to other provinces.

In addition to its economic and social benefits, the project is further justified by the support it would provide to government agencies in developing their capacity for planning and implementing rural development programs. The project is not expected to have any adverse ecological effects. The estimated economic rate of return on investment in village roads, accounting for 35 percent of total project costs, taking into account agricultural benefits and passenger cost savings, would be 20 percent. The estimated economic return (which includes the benefits arising from conversion of diesel operated rice mills and water pumps to electricity) on investment in village electrification, accounting for 15 percent of total project costs, would be 12 percent. Improvements in village water suppliers would reduce water-borne diseases and eliminate considerable unproductive time and effort devoted to hauling water over long distance. These benefits have not been quantified but are judged to justify the small per capita investment (about $3) in village wells.

Date approved: January 27, 1976 (IBRD)

LIVESTOCK DEVELOPMENT: This project will be carried out in 640 villages in northeast Thailand and will upgrade the quality and productivity of livestock through improvement of village pastures and animal husbandry practices, expansion of vaccine production and crossbreeding programs, improvement of disease control, and development of livestock-related research.

Borrower: The Kingdom of Thailand, Ministry of Agriculture and Cooperatives.

Loan: $5 million; 25 years at 4.5 percent per annum. Total project cost: $11.5 million.

Purpose and Benefits: The project would improve the yields and nutritive value of about 83,000 ha of fallow and permanent pasture areas, and accelerate the genetic and health improvement of cattle, primarily for beef and draught purposes. Quantified benefits in terms of additional livestock sales are expected to accrue to about 171,000 families. At least 110,000 of these families are among the poorest 40 percent of Thailand's population. The economic rate of return for quantified benefits, related to investments accounting for 85 percent of total project costs, is expected to be 68 percent. This high rate of return is due, in part, to the project's being built on a number of costly infrastructure and research efforts carried out in earlier years.

Date approved: January 27, 1976 (IBRD)

AGRICULTURE: The project comprises the rubber Replanting Aid Fund's (the Fund) replanting program for the period 1976–80 and has the following principal components: (a) replanting, using improved material and techniques, of about 25,000 ha of rubber in 1976–77; 35,000 ha in 1977–78; and about 50,000 ha in 1978–79 and 1979–90 respectively, for a total of about 160,000 ha (of which 80,000 ha would be incremental); (b) increasing the capacity of the Fund to cope with the production of high quality planting material for an annual replanting program of 50,000 ha; (c) maintenance of all immature replantings; (d) establishment of about 400 Group Marketing Organizations (GMOs); (e) increasing the use of modern yield stimulation techniques during the final three years prior to replanting on about 100,000 ha p.a.; (f) expanding smallholder training in techniques of planting, field maintenance, tapping, processing and marketing; (g) technical assistance for project planning and implementation by UNDP/FAO; (h) establishing a monitoring system to evaluate the socio-economic impact of, and rubber growers incentives and participation in, the replanting program; and (i) review and reorganization of the Fund's structure and procedures with the assistance of a team of management consultants.

Borrower: Thailand, The Rubber Replanting Aid Fund (the Fund).

Loan: $50.0 million; 22 years at 8.5 percent per annum. Total project cost: $148 million.

Purpose and Benefits: Accelerating the rubber replanting program would result in a faster rate of growth of incomes and production in South Thailand, fuller employment in the Region, and increased foreign exchange earnings for the national economy. The accelerated program would help establish the rubber industry on a sound agricultural and financial basis, improve the Fund's organization and capability, and set the basis for a continuous replanting effort at optimum levels. The establishment of GMOs would improve rubber quality standards and farmers' incomes. Clearing and land preparation of an incremental 30,000 ha/year would create about 30,000 additional jobs per year beginning in 1978/79.

Date approved: April 20, 1976 (IBRD)

TELECOMMUNICATIONS: This project is the second phase of the Telephone Organization of Thailand (TOT) FY 1972–79 Development Program and consists of: (a) Installation of 46,400 new lines of local exchange equipment with associated cables and subscriber facilities in the Bangkok Metropolitan Area to provide about 41,000 new connections. (b) Installation of about 9,500 lines of local exchange equipment with associated subscriber facilities in the rural areas to provide about 9,000 new connections. (c) Replacement of about 2,600 lines of manual exchange and mobile exchange equipment by automatic equipment in rural areas and about 28,000 pair kilometers of telephone cables and wires and 17,000 telephone sets. (d) Installation of 53 new long distance transmission systems in the rural areas and provision of about 6,500 channel ends for long distance circuits on the existing and new systems. (e) Installation of about 10,800 lines of trunk exchange equipment to provide nationwide service. (f) Installation of automatic message accounting equipment and automatic number identification equipment for approximately 440,000 lines.

Borrower: The Kingdom of Thailand, the Telephone Organization of Thailand (TOT).

Terms: $26 million; 20 years, including 4 years grace period with interest of 8.5 percent per annum. Total project cost: $94.3 million.

Purpose and Benefits: The project will expand and modernize local network capacity and provide 50,000 new connections to help meet part of the demand in Thailand and increase by 40 percent the number of towns and villages having telephone service. In rural areas, 42 new small towns and villages will be provided telephone service for the first time. With this modest expansion and the replacement of old and worn-out cables, wires and telephone instruments, the quality of service will improve significantly. The long distance items under the project provide for better utilization of existing transmission systems and extension of the long-distance network through 53 new systems to new areas in the hinterland.

Date approved: May 11, 1976 (IBRD)

EDUCATION: This project includes: the introduction of diversified curricula in 50 provincial secondary schools through the provision of additional classrooms, workshops, equipment, technical assistance and training; the establishment of a national adult education program comprising a national and four regional adult education centers responsible for research, curriculum development and training, and 24 life-long education centers responsible for extending adult education to 8,400 villages in their respective provinces, including the provision of necessary buildings, equipment, technical assistance and training.

Borrower: Thailand, Ministry of Education.

Loan: $31.0 million, 25 years at 8½ percent per annum. Total project cost: $78 million.

Purpose and Benefits: The provincial secondary school component will strengthen and accelerate the Government's program to diversify secondary education and reduce existing geographical imbalances. With the practical education received under the project, students would enter the labor market better trained and more employable. In addition, the project would reduce imbalances in the provision of secondary school places between Bangkok and the provinces and would help curtail the migration of secondary students into the Bangkok/Thonburi metropolitan area to complete the upper cycle of secondary school. The adult education system established under the project would help develop basic rural skills and improve the standard of living and quality of life for the estimated 75 percent of Thailand's population who have completed less than four years of formal schooling. The courses to be developed and tested in such areas as family planning, nutrition, health, hygiene, sanitation, functional literacy, light industry, crafts, and farm implement repair would be based on local research and evaluation of adult learning needs as determined by socio-economic differences in each region. The adult education system would also include correspondence courses reaching about 2,800 youths and adults annually and leading to primary and secondary school certificates.

Date approved: May 27, 1976 (IBRD)

TOGO

AGRICULTURE: This project will be carried out over the period 1976–81 and consists of: (a) improving and diversifying the production of the principal upland crops on some 18,500 ha and developing about 3,000 ha of low land for rainfed rice cultivation and providing credit for the purchase of 110 power tillers and 75 small rice mills; 25 ha of vegetable production and 600 ha of smallholder coconut; (b) infrastructure development through the construction of about 300 km of secondary and feeder roads; 20 tube wells and 2 earth dams; 15 dispensaries; 150 village stores; and 20 village markets; (c) studies to prepare: (i) a gravity irrigation scheme for 1,000 ha for rice cultivation and to make investment proposals for areas to be freed of onchocerciasis; and (ii) field trials to test techniques to restore the productivity of depleted soils and test the resistance of coconut hybrids to Kaincope disease; and (d) strengthening of Societe Regionale d'Amenagement et de Developpement de la Region Maritime (SORAD Maritime) and the Caisse Nationale de Credit Agricole (CNCA), the project's executing agencies.

Borrower: The Societe Regionale d'Amenagement et de Developpement de la Region Maritime (SORAD Maritime) and the Caisse Nationale de Credit Agricole (CNCA).

Loan: $9.5 million; 50 years at 0.75 percent per annum. Total project cost: $15.7 million.

Purpose and Benefits: The project's direct benefits would be an increase in foodcrop production which should, in turn, result in higher incomes for some 20,000 farm families expected to participate in the project. Overall, the net farm income of participant families would approximately double from about $80 to $170 in the poorest areas and from about $190 to $350 for the majority of families. Increases in cotton and groundnut exports and savings in foodgrain imports would improve the foreign exchange position. The project would also raise the general level of economic activity in the area by increasing the spending power of beneficiaries and thus their contribution to public revenue through indirect taxes. Improved health services would benefit about 150,000 people and about 44,000 people would benefit from water supply. The project would provide increased seasonal employment of family and hired labor. By strengthening SORAD's and CNCA's management, the project would contribute to the capacity of these agencies to plan and carry out other rural development projects. The project's attempt to rehabilitate depleted land would be of great importance for the overpopulated coastal plateau. The economic rate of return of the project would be 37 percent over 15 years (30 years for coconut plantings).

Date approved: June 8, 1976 (IDA)

TOGO/IVORY COAST/GHANA

INDUSTRY: This project includes two complementary components: (a) an industrial complex comprising a dry clinker plant of an annual capacity of 1.2 million tons to be built at Tabligbo, about 65 km northeast of Lome: it would comprise a quarry, two clinker production lines, storage and rail facilities; (b) related infrastructure comprising: (i) a railway line of about 80 km to connect the plant with the port of Lome, and railroad equipment; (ii) a rail port terminal within the port of Lome; (iii) a power link and sub-station connecting the plant to the existing network; and (iv) a township.

Borrower: Togo, Ivory Coast and Ghana, Climents de l'Afrique de l'Ouest (CIMAO).

Loan: $60 million; 15 years at 8.85 percent per annum. Total project cost: $284 million.

Purpose and Benefits: The main objective of the project is import substitution. The present dependence of the three countries on imports is risky; any disruption in world market production would inevitably result in supply shortages and considerable price increases. The economic rate of return of the project is 10.2 percent, based on a regional CIF price for clinker of $33/ton in 1975 constant prices during the first three years of operation. The project will generate direct employment for 2,500 to 3,000 persons during construction and for about 600 during operations. The indirect impact on downstream industries would not be very significant although, in the long run, CIMAO and other large industrial plants could give a decisive push to the development of small maintenance and repair industries. Net foreign exchange earnings (in 1975 terms) are estimated at about $13 million in 1980 (in 1975 terms) increasing gradually to $25 million per year.

Date approved: June 24, 1976 (IBRD)

TRINIDAD AND TOBAGO

TRANSPORTATION: This project consists of: (a) upgrading 7.6 miles of the East-West Transport Corridor and the constructing and improving about 2.6 miles of local roads; (b) strengthening 60 miles of paved rural roads; (c) providing consulting services for detailed engineering and construction supervision; and (d) technical assistance to Ministry of Works (Highways Division) for highway planning, pavement design and contract administration and to assist the Borrower in strengthening the domestic construction industry.

Borrower: Trinidad and Tobago, Minister of Works.

Loan: $7 million; 15 years with 8.5 percent interest rate per annum. Total project cost: $28.5 million.

Purpose and Benefits: The project content is varied, but its objectives are: (a) to help alleviate some of the pressing problems of severe traffic congestion along the East-West Corridor which is the main artery between Port-of-Spain and the rest of the country; (b) to help finance the longer-term solutions to the transportation problem in the Corridor, notably through preparations for a Bus Priority Route to help shift to mass transit from the private automobile; (c) to help strengthen and maintain rural roads to optimum standards and (d) to improve institutional capabilities in the Highways Division and in the domestic construction industry. On conservative assumptions, the economic rate of return for the construction element as a whole would be 25 percent. The rural roads are not designed for the traffic they now carry and in some sections the pavements have failed. Strengthening of these roads, which is estimated to cost about $35,000 per mile, would obviate the need for complete reconstruction, which would cost about $100,000 per mile. It is estimated that the economic return on this project component which accounts for about 11 percent of total project cost would be about 25 percent. Completion of the road upgrading is projected for 1981. Technical assistance to the Highways Division and the strengthening of the domestic construction industry would enable improved performance in management, administration, planning and supervision of civil works.

Date approved: March 30, 1976 (IBRD)

TUNISIA

EDUCATION: The project includes construction and equipment of 55 primary schools; expansion of the Tunisian pre-vocational training, Initiation aux Travaux Manuels (ITM), program for fifth and sixth graders through conversion and equipment for existing facilities in 156 schools into industry-oriented Initiation aux Travaux Manuels Industriels (ITMI) workshops and construction and equipment for new ITM workshops; extension of teacher-training schools; technical assistance to (i) the Planning Unit in the Ministry of Education to undertake educational reform studies and examine education/training and employment requirements in preparation of the Fifth Plan, (ii) the Evaluation Unit in the Ministry of Education to monitor the ITM program and undertake studies on new education program and teaching methods for primary schools, (iii) the Project Implementation Unit to design architectural plans for a possible follow-up education project suitable for external financing, and (iv) to finance fellowships to train Tunisians abroad.

Borrower: Republic of Tunisia.

Loan: $8.9 million; 50 years at 0.75 percent per annum. Total project cost: $27.6 million.

Purpose and Benefits: The project would assist the Government in strengthening current primary education reform programs and increasing the efficiency of the primary school system. Instruction in practical subjects will be introduced, relating the primary school curriculum to the local environment; teacher training and restructuring of the teacher training curriculum would be provided to facilitate efficient introduction of the new subjects into primary schools; a post-primary program would address the problems of integrating primary school leavers into productive society. Finally, education would be enhanced through studies to evaluate the effectiveness of changes introduced into the primary school program, to determine new reform measures, and to examine the interrelation of the labor market and the education and training system.

Date approved: July 1, 1975 (IBRD)

TRANSPORTATION: The project consists of the improvement of about 225 kilometers of the following roads: (i) Tunis-Libyan border road; (ii) Tunis-Medjex-el-Bab road; (iii) Beja-Jendouba road; (iv) Tunis-Bizerte road; and (v) Hammamet-Korba road. The Tunis-Libyan border road is one of the most heavily travelled roads in the country and the construction of bypasses at Sousse, El Djem, and Sfax should ease congestion considerably. The remaining roads are to be improved through resurfacing, strengthening, widening and, in some cases, realignment of existing sections. Bypasses will also be constructed around the towns of Hammamet, Nabeul, and Beni Khiar on the Hammamet-Korba road.

Borrower: Republic of Tunisia, Ministry of Education.

Loan: $28 million; 24 years at 8.5 percent per annum. Total project cost: $52.3 million.

Purpose and Benefits: The highways to be improved are those sections of Tunisia's highway network most in need of improvement. Present transportation costs on these sections are unduly high and the improvements will reduce vehicle operating costs, journey times, accidents and highway maintenance costs. Additionally, a shift to larger (more economic) vehicles will be possible and increased travel comfort available. The routes on which the project sections are located are inter-regional. Benefits will therefore accrue to both long distance and local traffic. The bypass sections will enable through traffic, particularly trucks, to avoid the towns of Sousse, El Djem, Sfax, Hammamet, Nabeul and Beni Khiar. Based on the most probable estimates of construction costs, vehicle operating costs, time costs, base year traffic and traffic growth, the proposed investments in the project roads sections will produce economic returns (ERs) ranging from 18.0 percent to 42.0 percent. The assistance for transport planning is justified since it will contribute to increased efficiency in highway administration and assist the Government in upgrading the highway network. The main purpose of the rural roads study, also to be financed, is to identify and analyze rural roads for construction and improvement in areas where their adequacy is a serious obstacle to rural and agricultural development.

Date approved: December 18, 1975 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: The loan funds will help to meet part of Banque de Developpement Economique de Tunisie (BDET's) requirements for financing import components of specific industrial enterprises for the next two years.

Borrower: Banque de Developpement Economique de Tunisie (BDET).

Loan: $20 million, at a maximum of 15 years at 8.5 percent per annum.

Purpose and Benefits: BDET's policies, established at the time of its reorganization in 1965, provide that BDET is to stimulate industrialization and the development of tourism in Tunisia through the financing of sound and productive projects. BDET has also played an important role in helping develop the Tunisian capital market. Through the projects it has financed in tourism and industry, BDET has made a substantial contribution to the improvement of Tunisia's foreign exchange position. Tourism remains a major foreign exchange earner and industry's share of foreign exchange receipts is expected to increase as the Government continues to encourage export-oriented industries. BDET's economic rate of return calculations on projects approved in 1975 showed returns ranging from 18 percent to 70 percent.

Date approved: January 6, 1976 (IBRD)

TURKEY

POWER: The project includes: (a) the construction and placing into operation of 380/154 kV and 154/33 kV substations having aggregate capacities of about 3,200 MVA, and 755 km of related transmission lines in various parts of Turkey, including the link between Elbistan and Keban and a second crossing of the Bosphorus; (b) the training of Turkish Electricity Authority (TEK) engineers in transmission system design and operation; (c) a nationwide power tariff study as well as a study of TEK's medium and long-term professional personnel staffing needs for the period 1977–81; and (d) project engineering and related studies.

Borrower: Turkish Electricity Authority (TEK).

Loan: $56.0 million; 20 years at $8\frac{1}{2}$ percent. Total project cost: $146 million.

Purpose and Benefits: Over the life of the proposed project, TEK has planned new generating capacity, including Elbistan, in excess of 2,500 MW to meet the forecast increase in demand for electrical energy. The transmission program is essential to balance the major investments being made in generating capacity (e.g. Keban and Elbistan). Economic benefits cannot be attributed directly to the Project, so no rate of return can be calculated. However, the internal rate of return for TEK's

TURKEY—Continued

total development plan has been calculated to be at least 16 percent, with additional benefits which will arise from improving the reliability of electricity supply.

Date approved: November 18, 1975 (IBRD)

AGRICULTURE: This project will help finance part of the Agricultural Bank of Turkey's (TCZB) agricultural investment program over three years by means of provision of credit for: (a) supervised loans to farmers for investment and production costs in crops and livestock; (b) expansion of investment in certain categories of agro-industries; (c) purchase of one ferryboat for fruit and vegetable truck transport to trans-Mediterranean markets; and (d) purchase of vehicles for TCZB field staff. It would also help strengthen the operations, financial practices and technical capabilities of TCZB through consultants and experts for technical assistance and training.

Borrower: The Agricultural Bank of Turkey (TCZB).

Loan: $63 million; 15 years at 8.5 percent per annum. Total project cost: $172.8 million.

Purpose and Benefits: The economic rate of return on this project has been calculated at 36 percent on total project investments. Rates of return for individual components are: 52 percent for supervised credit; 19 percent for agroindustry; 33 percent for the ferryboat; very high for cattle-fattening (because of the short production period). About 120,000 persons would benefit from the project, most of them in central and eastern Turkey where the potential for expanding grain and beef production is fairly high. About 88 percent of the farmers benefitting directly from the agricultural components would belong to the "target group" (with less than $285 per capita income in 1975), and would receive 74 percent of the loan amount. The project would generate over 15,000 man-years of employment opportunities during the investment period and over 7,000 annually thereafter.

Date approved: April 27, 1976 (IBRD)

INDUSTRY: The project provides for the construction of an integrated sawmill and newsprint manufacturing complex at Balikesir, which includes the following: (a) a sawmill producing about 105,000 m^3 per year of air-dried sawn wood; (b) a wood preparation plant to produce about 86,000 m^3 per year of wood chips; (c) a thermo-mechanical pulp mill to produce about 79,100 bone dry tons per year of wood pulp; (d) a newsprint mill producing about 100,000 tons per year of newsprint; (e) ancillary facilities including pollution control equipment and an approximately 9 MW turbogenerators; (f) a town site with housing for about 1,000 people; (g) technical assistance for: (i) engineering and construction supervision; (ii) training; (iii) operational and management assistance.

Borrower: Turkiye Seluloz ve Kagit Fabrikalari Isletmesi (SEKA) and SEKA Balikesir Muessesesi (Balikesir Establishment).

Loan: $70.0 million; 15 years at 8.5 percent per annum. Total project cost: $185 million.

Purpose and Benefits: The economic rate of return for the project, including the townsite, is estimated at about 16 percent. Direct employment effects are small in relation to the investment, in total about 850 employees will be required. However, about another 2,500 jobs are expected to be generated in forestry operations related to the project. Net annual foreign exchange savings, which are important for a country like Turkey which is experiencing pressures on its balance of payments, are estimated at $34 million as compared with total project foreign exchange requirements of $82 million. This implies that after the Balikesir plant goes into production, the foreign exchange cost of the project will be paid off within 2½ years, through the foreign exchange savings resulting from reduced newsprint imports.

Date approved: May 18, 1976 (IBRD)

AGRICULTURE: This project provides for a five-year lending program by the Agricultural Bank of Turkey (TCZB) for on-farm dairy investments benefitting 750 farmers. About 10,500 pure bred cattle will be imported to serve as a nucleus of genetically superior stock for upgrading the national herd. The project would also provide project farmers with varied farm machinery (tractors, sowing and harvesting equipment, milking machines, pumps and tools) associated with dairy farming. Three individual technical specialists would provide technical assistance in planning, extension, and supervision services which would be provided by the Intensive Dairy Production Division (IDPD). Training of local technicians would be provided both locally and abroad. The project includes production and marketing studies for subsequent development of the dairy industry, and those for the preparation of a future intensive dairy development project in additional provinces.

Borrower: Republic of Turkey, Agricultural Bank of Turkey (TCZB).

Loan: $21.5 million; 17 years at 8.5 percent per annum. Total project cost: $34.7 million.

Purpose and Benefits: The economic rate of return is estimated at 22 percent. Direct economic benefits of the project at full development would arise from the incremental production of 45 million liters of milk valued at some $10 million per year and around 10,000 quality cattle for dairying and breeding worth $3.3 million per year. Long-term benefits include improvement in the milking quality of the national herd, improved land utilization and animal productivity, improved institutional infrastructure for future dairy development, pilot lending to very small dairy farmers, and greater utilization and increased operating efficiency of Government milk plants.

Date approved: May 25, 1976 (IBRD)

UPPER VOLTA

AGRICULTURE: This project provides a line of credit to the Rural Development Fund (Fonds De Developpement Rural—FDR) for investment in small-scale rural projects, the main purpose of which would be to increase crop production and improve village water supplies. Program activities have been tentatively determined and would include: bottomland development (2,700 ha); erosion control works (9,200 ha); small-scale irrigation and improved bottomland development (500 ha); construction of 520 wells, 180 tubewells, 400 village warehouses and 20 village centers; provision of medium-term credit for agricultural equipment, $0.5 million and provision for unidentified projects. In addition, studies for economic development of areas freed from onchocerciasis would also be financed under the project.

Borrower: Republic of Upper Volta, Rural Development Fund.

Loan: $9.4 million; 50 years at 0.75 percent per annum. Total project cost: $16.2 million.

Purpose and Benefits: The project will provide important social and institutional benefits. For example, village wells give an assured and healthful water supply to the human population, which is otherwise dependent upon small creeks which run dry for at least three months of the year and which may contain waterborne diseases; and the Regional Development Organization (ORD), among other institutions, are strengthened in assuming responsibility for identifying and proposing subprojects, greatly increasing their contact with farmers and involvement in rural development. A cautious estimate would put the total number of farm families likely to benefit under the project at around 15,000 (between 120,000 to 190,000 people). It is estimated that about 600 villages would be involved in the project.

The estimated subproject economic rates of return are: bottomlands (accounting for $.5 million), over 50%; erosion control (accounting for $0.6 million) 30%; improved bottomlands (accounting for $.2 million) 18%; small-scale irrigation (accounting for $.9 million) 16%; and agricultural equipment (accounting for $.7 million), over 50%. The rate of return for wells and tubewells (accounting for $2.4 million and $.7 million respectively) would be 6%, excluding such benefits as improvements in health and water supplies. If wells and tubewells were excluded, the overall economic rate of return would be 21%. The investment package as proposed should yield an economic rate of return of about 16%.

Date approved: June 8, 1976 (IDA)

URUGUAY

AGRICULTURE: The project would support the Government's Livestock Development Program during 1976 and 1977 and would consist of: (a) investments totalling US$23.8 million for pasture and other on-ranch improvements; (b) investments of about US$0.8 million to help develop contractor machinery services; (c) US$1.2 million for technical assistance to help improve pasture technology and management and train local personnel; and (d) a contingency allowance of US$6.9 million. The proposed project would be implemented nationwide.

Borrower: Republic of Uruguay, Central Bank's Livestock Fund.

Loan: $17.0 million; 15 years at 8½ percent. Total project cost is $32.2 million.

Purpose and Benefits: Over the short-run, the project would contribute to enlarging the country's capacity to retain heifers, while over the long-run, it would facilitate the expansion of beef exports. The more intensive use of existing pastures would permit the continuing use of fertile land for crop production, or even eventually free some land presently under pasture for such production and, in this way, contribute to increased agricultural production for export. The project's overall rate of return to the economy is estimated at 18 percent; the rate of return on the beef component is estimated at 17 percent and on the dairy component at 20 percent. The financial rates of return are 16 percent for beef production and 22 percent for dairy production, sufficiently high rates to make these investments attractive to producers.

Date approved: October 7, 1975 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: These loan funds would support a relending program to industrial export enterprises to finance the cost of importing working capital items and machinery and equipment. The project would also include technical assistance to Government institutions in the industrial sector. This loan has three components, namely: an imported working capital component of US$24.5 million, a medium- and long-term investment (plant renovation and expansion) financing component of US$10 million and a technical assistance component of US$.5 million.

Borrower: Republic of Uruguay, Central Bank's Industrial Export Promotion Fund.

Loan: $35.0 million; 18 years at 8.5 percent.

Purpose and Benefits: The loan's purpose is to assist the Government in its efforts to reactivate industrial output through the expansion of manufactured exports. Higher industrial production will encourage increased employment, while expanded manufactured exports would contribute to diversifying export earnings and to making the balance of payments less vulnerable to fluctuations in world demand and prices for beef and wool.

Date approved: December 2, 1975 (IBRD)

YEMEN ARAB REPUBLIC

EDUCATION: The project is designed to complement, strengthen and expand the reform measures initiated under the first education project. The project will: (i) introduce more relevant training programs in primary teacher training institutes while expanding provision for the training of women teachers; (ii) reinforce the development of basic training programs for non-literate adolescents and adults and extending such training into the villages and remote rural areas; (iii) expand vocational training to assist in meeting the shortage of skilled labor in the country; and (iv) raise the quality of instruction through the provision of suitable instructional materials.

Borrower: Yemen Arab Republic, Ministry of Education.

Loan: $8.0 million; 50 years at 0.75 percent per annum. Total project cost: $11.9 million.

Purpose and Benefits: Despite a rapid growth in enrollments over the past few years (about 30 percent per annum between 1969 and 1973 and 20 percent in 1974), Yemen's education system is still among the least developed in the world. The equivalent of only 15 percent of the 6–11 age group were attending primary schools, of which only 12 percent were girls. A random sampling suggests that about 70 percent of students may be overaged due to late entry which varies from about eight years of age in the cities to about eleven years of age in rural areas. Only about 13 percent of primary schools offer the full range of grades and about 60 percent of the schools have only three grade levels or less. New district training centers will provide courses in literacy, basic occupational skills, and agriculture; in addition, women will receive instruction in health, hygiene, nutrition, child care, and domestic crafts. As many as 20,000 rural inhabitants yearly will receive training. The project will also strengthen and expand reform measures initiated through a previous (fiscal 1974) IDA-assisted project by introducing more relevant training programs in primary teacher training institutes, while expanding provisions for the training of women teachers. The UNDP will participate with about $2.24 million in the financing of the project.

Date approved: February 10, 1976 (IDA)

AGRICULTURE: This project forms the first phase of a long-term program to expand and improve Yemen's grain handling, storage and processing systems. It aims to: (a) curb grain storage losses; (b) reduce handling and import costs; (c) improve the sanitary conditions of the supply of bread; and (d) alleviate malnutrition and up-

YEMEN ARAB REPUBLIC—Continued

grade nutrition standards. In addition, provision of better bread would reduce inefficient home baking and decrease damaging deforestation. The project will include: (a) 20,000 ton modern port silo in Hodeida with ship unloading and bagging equipment; (b) six regional warehouses with a total capacity of 18,000 tons; (c) two Government operated bakeries, including small whole grain flour mills to serve them with a capacity of about 10 tons per day each; (d) a bakery credit component to provide loans to private sector bakers; (e) a study to provide a nationwide storage investment program based on a survey of existing grain storage capacity and quality as well as on future production and consumption trends by region; (f) a nutrition component including bread fortification with vitamins and minerals, nutrition promotion and planning.

Borrower: Yemen Arab Republic, Yemen General Grain Corporation (YGGC).

Loan: $5.2 million; 50 years at 0.75 percent per annum. Total project cost: $21.8 million.

Purpose and Benefits: A net total of about 65 fulltime and 70 man-years of part-time positions would be created. With the establishment of the YGGC and the strengthening of the Agricultural Credit Fund (ACF) as well as the training and technical assistance provided under the project, a major institution-building would be achieved. An estimated 176,000 consumers of which about 67,000 are students, welfare recipients and hospitalized persons, would obtain higher quality bread. The economic rate of return is estimated to be 41 percent for the silo component, the cost of which is $7 million, and 17 percent for the warehouse component, the cost of which is $2.5 million, and finally 20 percent for the bakery component, the cost of which is $4.6 million. These rates of return do not take into account the following non-quantified benefits: (i) savings due to reduced shipping freight rates for general cargo as a result of decreased port congestion; (ii) the contribution of sanitary grain storage and bread production to better health; and (iii) environmental benefits due to decreased deforestation. The average economic rate of return on these components, which account for 93 percent of total project cost, is estimated at 32 percent.

Date approved: June 3, 1976 (IDA)

YEMEN, PEOPLE'S DEMOCRATIC REPUBLIC

TRANSPORTATION: The project is to rehabilitate the port of Aden and provides (a) floating equipment including tugs, mooring and pilot launches, cargo barges; (b) cargo handling equipment including mobile cranes, fork-lifts, tractors, trailers, and capstan winches; (c) workshop equipment, spares and stocks; (d) diving team equipment; (e) navigation, mooring and communications equipment; and (f) technical assistance.

Borrower: People's Democratic Republic of Yemen, Yemen Ports and Shipping Corporation (YPSC).

Loan: $3.2 million; 50 years at 0.75 percent. Total project cost: $17.6 million.

Purpose and Benefits: The equipment provided under the project, in conjunction with the technical assistance obtained from bilateral sources, will ensure that the port is both safe and quick and that a complete line of ship services, including bunkering and ship machinery repair and maintenance is offered. The objective is to adequately equip it as a service port capable of reattracting the traffic passing through the Suez Canal since its reopening. The expected increase in YPSC net revenues before tax is the measure of the economic benefits attributable to the investment. On this basis, the economic rate of return, over an average 15 years life of the investment, is more than 25 percent. In addition to the direct benefits, the project is expected to stimulate economic activity in the country in general.

Date approved: August 21, 1975 (IDA)

YEMEN: PDR

AGRICULTURE: The project aims at increasing agricultural production on about 9,000 ha of irrigated land in the Wadi Hadramawt through provision of agricultural equipment and supplies, construction of feeder roads and extension services. The project would also include a date packaging plant to reduce losses through spoilage and to create a source of additional income to farmers in the Wadi; a rural water supply component to improve living and health conditions; and a feasibility study to assess possibilities for agricultural expansion.

Borrower: The People's Democratic Republic of Yemen, Hadramawt Project Organization (HPO).

Loan: $7 million; 50 years at 0.75 percent. Total project cost: $7.7 million.

Purpose and Benefits: The project will effect essential institutional and physical improvements which are prerequisites for the development of the Wadi Hadramawt Region. The transition from current subsistence agriculture toward the production of marketable surpluses through the training of farmers in modern production techniques and rational use of farm inputs will facilitate the shift to high value crops, particularly when the Mukalla-Wadi Hadramawt road link becomes available in 1979. The infrastructure component of the project will support agricultural development and improve living conditions and welfare of the rural population. Possibilities for expansion of agriculture in the Wadi will be identified in a Wadi Hadramawt Development Study which will be partly financed under the project. The principal beneficiaries in terms of additional employment and income will be about 5,000 member families of farm cooperatives or some 30,000 people, whose per capita income is now some $70, well under the national average of about $110 in 1973. In addition, the project will reduce the need for Government subsidies to cooperatives and state farms and increase public revenues, resulting in a net reduction in the annual drain on the Government budget from $1.1 million to $0.4 million. The project will generate direct economic benefits by a substantial increase in yields of all annual crops produced in the area and by a more modest increase in the value added of packaged dates. Increased wheat production and the related reduction in wheat imports will result in annual foreign exchange savings of about $1,000,000. Disregarding the cost of the Wadi Hadramawt Development Study, the project's rate of return with agricultural labor valued at one-third of going wage rates to reflect substantial underemployment is estimated at 17 percent. The economic rate of return of the date packing plant alone is estimated at 11 percent.

Date approved: February 19, 1976 (IDA)

YUGOSLAVIA

TRANSPORTATION: The project comprises: (a) the construction and supervision of the following highway sections: (i) in the Republic of Slovenia, a four-lane divided highway between Dolgi-Most and Vrhnika (11.4 km); (ii) in the Republic of Serbia, a four-lane divided highway between Surcin (airport) and Belgrade (8.0 km) and between Belgrade (Ring Road) and Mali Pozarevac (21.5 km); (iii) in the Republic of Montenegro, a two-lane highway between Titograd and Niksic (49.4 km); and (b) the provision of 12 man-months of training in the preparation of highway feasibility studies.

Borrowers: The Republic Community for Roads—Slovenia, Association of Enterprises for Roads—Serbia, and Community for Roads—Montenegro.

Loan: $40.0 million; 23 years at 8.5 percent per annum. Total project cost: $117.4 million.

Purpose and Benefits: The project road sections would help meet the heavy transportation demand generated by Yugoslavia's growing manufacturing and tourism industries. The existing highways in the project areas are inadequate for both present and forecast traffic volumes, and without the improvements provided for in the project, bottlenecks would arise. In Slovenia, the subproject is part of the country's primary highway network, serving both internal and international traffic. Traffic on this road is expected to grow at between 5–9 percent annually over the next 20 years. The economic rate of return for this subproject is estimated to be 20.5 percent. The Serbian subproject also forms part of Yugoslavia's primary highway network, serving not only domestic traffic but also the transit of major commodities across Europe. These sections in Serbia are already badly congested, and traffic on them is expected to grow at annual rates between 4 and 11 percent over the next 20 years. The economic rates of return on the Serbian section range between 19 and 49 percent. The project road in Montenegro is a main artery of the Republic, leading partly over very rough terrain. The road and the adjacent railway handle most of the traffic for four major local industries, and are considered to an extent, export-oriented. The present road and railway cannot cope with the projected expansion of the local industries. The new road would offer considerable economies for the transport of bauxite, the major freight component between Niksic and Titograd, which can be trucked directly from the mines to the refinery at Titograd. Total traffic is expected to double between 1973 and 1980 and to increase by another 50 percent by 1985. The benefits from the improvement derive largely from savings in vehicle operating costs and time savings. The economic rate of returns are 15 percent and 19 percent for the two subsections of the road.

Date approved: July 8, 1975 (IBRD)

TRANSPORTATION: The project includes: (a) Port facilities comprising: i) two marine berths and related equipment capable of handling ships from 30,000 dwt to 350,000 dwt, ii) two 2,000 hp tugs and several launches, and iii) one 612,000 ton oil storage tank farm, (b) Overland transport facilities including: i) 736 km of main pipeline varying in size from 12 to 36 inches and lateral pipelines to refineries, ii) 7 pump stations, iii) 2 maintenance depots, iv) 1 pressure reduction station, v) 4 buffer oil storage tank farms (with a total capacity of 153,500 tons), and vi) an existing 16 inch pipeline to be incorporated into the system.

Borrower: Jugoslavenski Naftovod Poduzece Za Transport Nafte U Osnivanju, Rijeka (Yugoslav Oil Pipeline Enterprise).

Loan: $49 million; 18 years at 8.5 percent. Total project cost: $377 million.

Purpose and Benefits: The project would provide an oil receiving port and overland transport of crude oil by pipeline to five inland refineries and to Hungary and Czechoslovakia. On completion, the installations would have a capacity of 20 million tons annually. The benefits derived from the project would be savings in transportation costs which are estimated at about 1 percent of the average sales price of oil products. During construction, the pipeline would provide employment to some 2,000 persons while during operations some 350 staff would be employed. The increase in the transport of refined oil products and other cargo resulting from normal growth of the economy would, in a short time, make up any temporary slack created by the pipeline in the railways and the few local waterways carriers involved.

Date approved: November 4, 1975 (IBRD)

WATER SUPPLY AND SEWERAGE: This project has three primary objectives and components: (a) assistance to the Republic of Serbia to improve the planning and management of water resources within the Morava region in order to promote accelerated economic development in the least-developed areas of the Morava River basin, to include a study of ways to accelerate economic development in three of the least-developed areas of the Morava River basin; (b) provision of improved water supplies and extension of the sewer networks in the towns of Titovo Uzice and Cacak; and (c) demonstration irrigation schemes.

Borrower: Socialist Federal Republic of Yugoslavia, Republicki Fond Voda (Socialist Republic of Serbia Water Fund). (SWF).

Loan: $20 million; 20 years at 4.5 percent per annum. Total project cost: $51.4 million.

Purpose and Benefits: The major objectives of the project are to improve the planning and management of water resources within the Morava region in order to overcome water-related problems and accelerate the economic development of the least-developed areas in the region. To this end, the water resources and economic development studies are designed to generate programs whose benefits are expected to be substantial; these would include reduction of flood damage, siltation control, improved irrigation practices, improved water supplies and river pollution control. A national objective in Yugoslavia is to assist small farmers to increase agricultural output and improve their standard of living. One method of accomplishing this in the Morava region would be to increase agricultural production through the use of low cost, supplemental irrigation schemes. Preliminary information indicates that the pilot irrigation projects in Milosevac and Aleksinac would be economically viable, providing rates of return of approximately 20 percent. In both Titovo Uzice and Cacak, the industrial and domestic requirements for treated water exceed the available supplies. In both towns existing facilities are inadequate, with less than 60 percent of the residents supplied by the water systems. With the expansion and improvement of the water supply and sewage disposal systems, adequate potable water would be available to 90 percent of the population and the threat of water-borne diseases would be significantly reduced. There would be a variety of benefits, including medical cost savings, increased productivity of workers, and savings on future septic tank expenditures.

Date approved: May 20, 1976 (IBRD)

WATER SUPPLY AND SEWERAGE: Essential features of this project are: (a) Water supply: (i) Construction of an infiltration gallery, reservoirs and pumping stations, YUGOSLAVIA—Continued

and expansion of existing reservoirs and pumping stations; (ii) installation and replacement of water mains and distribution pipes, and replacement of obsolete service connections; (iii) installation of a control system and master meters; (iv) engineering services. (b) Sewerage: (i) construction of collectors and main sewers and replacement of worn-out sewer laterals and service connections; (ii) construction of a sewage treatment facilities (including a pilot plant), sludge filters and facilities for disposal of sludge, and (iii) engineering services.

Borrower: Sarajevo Water Supply and Sewerage Enterprise, (Vodovod) Socialist Federal Republic of Yugoslavia.

Loan: $45.0 million; 25 years at 8.5 percent per annum. Total project cost: $95.7 million.

Purpose and Benefits: The major justification for the sewerage system investment is that the collection and treatment of sewage in Sarajevo is necessary for healthful and orderly development of the area and the proposed method of collecting and treating the sewage is the least cost solution. The pollution of river water in Sarajevo threatens the health and well-being of its population as well as the population residing along the Bosna River downstream from Sarajevo. With the expansion and improvement of the water supply and sewage disposal systems adequate potable water would be available and the threat of waterborne diseases would be significantly reduced. There would be a variety of benefits, including medical cost savings, increased productivity of workers, savings on future septic tank expenditures, increase in property values along currently polluted waterways and an increase in the recreational potential of these waterways. The internal economic rate of return of the water supply system would be about 15.6 percent.

Date approved: May 25, 1976 (IBRD)

WATER SUPPLY AND SEWERAGE: This project will provide facilities to abate air pollution in Sarajevo. A natural gas transmission and distribution system would be installed and heating units will be converted to burn gas. Essential features of the project are: (i) construction of about 265 km of natural gas transmission line from Batajnica (near Belgrade) via Zvornik to Sarajevo; (ii) construction of about 28 km of high pressure distribution pipeline and metering substations to supply four industrial consumers; (iii) construction of 20 km of distribution ring, about 50 pressure regulating stations, about 160 km of service lines; (iv) conversion of about 300 central heating plants and installation of about 10,000 house connections, and (v) technical assistance.

Borrower: Sarajevo Gas Enterprise (SGE), Natfagas Gas Unit (NGU).

Loan: $38.0 million: (a) SGE would receive $27.0 million and (b) NGU would receive $11.0 million, 25 years and 20 years respectively, at 8.5 percent per annum. Total project cost: $74.9 million.

Purpose and Benefits: Studies have shown that the most economic means of reducing air pollution to generally recognized acceptable levels in Sarajevo would be to introduce natural or manufactured gas as heating fuel. The average number of days per year in the winter period in which the city's air quality standard would be exceeded, would drop from about 70 to about 6. The result would be a healthier population which would require less medical care; would have lower job and school absentee rates; and, would be more productive on the job. In addition, the general improvement in the city's environment would enhance property values, reduce building maintenance costs, and expand the potential for recreational facilities. Sarajevo would become a better place in which to live and work. The cost of heating houses with natural gas would be about 11 percent higher than with the fuels now used, but about 20 percent lower than the projected costs of using the second best low-polluting fuels (coke, light oil, etc.). Using the second best fuels would not reduce pollution to acceptable levels. The use of gas for heat would thus be the least expensive way for Sarajevo to achieve air quality which would not be a hazard to the health of its citizens.

Date approved: May 25, 1976 (IBRD)

INTERMEDIATE CREDIT INSTITUTION: This loan will help to finance the foreign exchange cost of imported equipment for investments in medium- and small-size industrial projects in the Republics of Bosnia-Herzegovina, Montenegro, Macedonia and the Autonomous Province of Kosovo. Individual sub-loans would be repaid over a period not exceeding 15 years including grace periods of normally up to three years and in cases of co-financing of foreign exchange costs up to six years. The banks would onlend the proceeds at 11 percent per annum with the sub-borrowers carrying the foreign exchange risk.

Borrowers: Socialist Federal Republic of Yugoslavia, Privredna Banka Sarajevo (PSB), Stopanska Banka Skopje (SBS), Investiciona Banka Titograd (IBT), and Kosovska Banka Pristina (KBP).

Loan: $50 million, with interest at 8.5 percent per annum. Repayment would be according to a schedule reflecting the composite amortization schedules of the sub-loans financed.

Purpose and Benefits: In addition to providing foreign exchange resources to Yugoslavia to finance industrial development, this loan pursues the complementary objectives of (i) supporting the Yugoslavs' efforts to reduce regional economic imbalances through the development of a modern, efficient and competitive industrial base for the economy of the four less developed regions, and (ii) institution-building of the four banks, related essentially to their long-term industrial operations. Institutional aspects that will receive particular attention during the second industrial credit project are the strengthening of the banks' project staff, especially for supervision work: strengthening of project appraisal techniques, and the use of financial and economic rate of return analysis for projects other than those financed by the Bank loan; improving management information systems and implementing internationally recognized auditing standards; and adopting a medium-term (about 5 years) operational and financial planning horizon. Small- and medium-size projects with a total cost of normally up to US$6.0 million would be eligible for Bank financing under the proposed loan. However, in cases where the Bank sub-loans are supplemented by other foreign exchange financing, projects with total costs of normally up to US$10.0 million would be eligible.

Date approved: May 28, 1976 (IBRD)

ZAIRE

EDUCATION: This project includes: (a) construction, furniture, equipment and technical assistance for five new rural primary teacher training institutes, including five new primary schools for practice teaching; (b) rehabilitation, repair, equipment and technical assistance for six agricultural technician training institutes and one Higher Institute of Agricultural Studies; (c) fellowship programs; (d) evaluation of new programs promoted in the rural primary teacher training institutes and in the agricultural training institutes; and (e) pre-investment studies.

Borrower: Republic of Zaire, Department of National Education.

Loan: $21 million; 50 years at 0.75 percent per annum. Total project cost is $48.5 million.

Purpose and Benefits: Three-quarters of Zaire's population make their living from agriculture, a sector which has proven potential not only to feed the country, but also to be a major source of exports. In the past, Zaire's exports were divided in nearly equal parts between agriculture and minerals. Due mainly to the deterioration of the plantations and the marketing and transport system, agricultural exports are less than 20 percent of total merchandise exports. The poor situation in the agricultural sector has also had adverse social impact, provoking a massive migration from the rural areas to the cities with a sequel of problems such as unemployment and malnutrition. Improving education in the rural areas and providing the farmers with adequate technical assistance are two important elements of an overall strategy of rural development that is beginning to emerge in Zaire. The project is the first major effort of Zaire to improve educational facilities in rural areas. It addresses itself to two critical needs. It will help provide well-trained teachers for rural extension services.

Date approved: April 13, 1976 (IDA)

WATER SUPPLY: These loan funds will help finance the extension and rehabilitation of water supply facilities of six cities including pipe for primary and secondary distribution, pumping and water treatment equipment, and civil works; engineering services, a training program for Regie des Distributions d'Eau et d'Electricite (Regideso) and additional feasibility studies.

Borrower: Republic of Zaire, Regie des Distributions d'Eau et d'Electricite (Regideso).

Loan: $21.5 million; 50 years at 0.75 percent per annum. Total project cost: $70.4 million.

Purpose and Benefits: The project will improve the supply of water in six major cities with an aggregate population of 1.5 million—only about one-third of whose present population has access to piped water—and about 1.0 million urban poor will be served at a cost of about US$50 per additional consumer. More than half of the new consumers are intended to be served through standpipes. The project has been designed to supply water to the whole population of the six urbanized areas by 1980. Among its other effects the project is expected to substantially reduce the high incidence of waterborne diseases among the urban poor.

Date approved: April 13, 1976 (IDA)

ZAMBIA

INTERMEDIATE CREDIT INSTITUTION: The loan funds will help to meet part of the Development Bank of Zambia (DBZ) financial requirements for the financing of the import component of industrial, tourism and large agricultural projects through March 1978.

Borrower: Development Bank of Zambia (DBZ).

Loan: $15.0 million, repayable substantially in conformity with the aggregate of the amortization schedules at 8.5 percent.

Purpose and Benefits: Zambia's dependence on copper exports has meant uncertainty for the economy as prices fluctuate. The Government is anxious to diversify and broaden the economic base and has established DBZ to play an important role in this diversification process. Although agriculture is expected to be the mainstay of the economy, in the near future industry—its share of GDP (13.2 percent) now exceeds that of agriculture (10.5 percent) —holds better promise for diversification. DBZ has a pipeline of promising projects, which appear to be consistent with the country's objectives. DBZ and the country are constrained by a shortage of industrial investment funds. This loan would fill the resource gap and enable DBZ to cover its operations until March 1978. Presently DBZ is the only institution in Zambia which undertakes comprehensive appraisal work on industrial projects. As a new and developing institution it needs assistance to improve its appraisal capacity and this assistance can be provided by the Bank and IFC.

Date approved: February 10, 1976 (IBRD)

ARGENTINA

INDUSTRY: This loan will help construct and improve ACINDAR's port facilities on the Parana River, installations for unloading, conveying and storing iron ore in bulk or pellets; installation and mounting of a reduction plant with a 462,000-ton annual capacity; three electric arc furnaces with a capacity of 220,000 tons annually each, and two continuous casting machines. Similarly, ACINDAR will expand auxiliary services, which consist of an electrical system, oxygen plant, water system, laboratory and offices, as well as a rail and road system to connect the new units to the present plant.

Borrower: Acindar (Industria Argentina de Aceros, S.A.). *Guarantor:* Argentine Nation.

Terms: $55.0 million from Ordinary Capital resources; 15 years at 8 percent per annum. $15 million supplementary line of credit, 7 years at a variable interest rate. Total cost: $180 million.

Purpose and Benefits: The steel industry in Argentina has developed satisfactorily in recent years. In 1960, consumption of steel was 2.1 million tons of which 73 percent was accounted for by imports of finished products. By 1973, consumption had risen to 4.7 million tons, of which only 54 percent was imported. Nonetheless, Argentina has a structural deficit in steel due mainly to a lack of integral steel plants and a shortage of known reserves of iron ore and coking coal. To reduce this deficit, ACINDAR has initiated a program to expand its production of steel billets from 300,000 to 600,000 tons per year at its Villa Constitucion plant. To accomplish this, it will install a new technological process—the MIDREX system—which will allow the use of basic raw material (mineral bulk or steel billets) without increasing the present consumption levels of scrap metal.

Date approved: October 9, 1975 (IDB)

FORESTRY: The project to be financed in part with this loan is a credit program designed to assist in financing 100,000 hectares of forest plantings. The program would be executed by the Banco de la Nacion Argentina with technical support from the Instituto Forestal Nacional (IFONA) and would be divided into two subprograms, one each for small- and medium-scale forestry producers. It is estimated that execution of the program would benefit approximately 3,000 producers, 80 percent of them small producers. The species to be cultivated include salicaceae, conifers and eucalyptus.

Borrower: The Argentine Nation.

Loans: $30.0 million ($5 million Ordinary Capital), 20 years at 8 percent per annum ($5 million FSO, 25 years at 4 percent per annum). Total project cost: $60 million equivalent.

Purpose and Benefits: Argentina is one of the largest importers of wood and forest products in Latin America. Seventy million hectares, or 15 percent of the country's area, is wooded and the annual volume of timber extracted is approximately 6.3 million cubic meters, or more than 1.1 million cubic meters in excess of the estimated tree growth in exploited woodlands. Production does not, however, meet domestic demand and imports of raw materials and goods of forest origin have risen to the equivalent of US$200 million annually in recent years. With the aim of achieving domestic self-sufficiency in timber and other forest products and making suitable use of extensive areas not being sufficiently utilized, the Argentine Government's National Three-Year Plan of Reconstruction and Liberation provides incentives for the planting of 200,000 hectares of selected wood species. The program to be carried out with the Bank's cooperation would contribute to the achievement of this aim.

Date approved: December 4, 1975 (IDB)

BARBADOS

HEALTH: This project will improve sanitation conditions in central Bridgetown through construction of a sanitary sewerage system. The project includes: (a) a waste water collector system; (b) a sewage treatment plant; and (c) an underwater effluent discharge. Estimates indicate the project will benefit a population of 37,700 by the end of its design period. Plans call for technical cooperation to assist the government in making institutional and rate studies related to the organization of the authority which will administer the sewerage system and also assume the administrative functions for the water system now carried out by the Barbados Waterworks Department (BWD).

Borrower: Barbados. Executing agency: Ministry of Health and Welfare.

Loan: $9.7 million from FSO, 35 years at 2 percent per annum, 8½ year grace period. $100,000 nonreimbursable technical assistance from FSO. Total project cost is $13.6 million.

Purpose and Benefits: The size and high population density of Barbados make improved sanitation of central Bridgetown a project of national scope. The project will benefit not only the direct users but all residents and visitors of the country by eliminating this local point of pollution which adversely affects the whole coast of the island. The IDB justifies using the resources of the Fund for Special Operations on grounds that the project involves financing a social project in a country of limited market. It has been IDB policy to consider sewerage system projects for FSO financing, particularly when such projects help eliminate dangerous health conditions and raise health standards.

Date approved: October 9, 1975 (IDB)

BOLIVIA

DEVELOPMENT FINANCE COMPANY: These loan funds will help provide subloans through the Banco Industrial to the following categories of private industry: (a) Industry with fixed assets, excluding real estate, not in excess of the equivalent of $1.0 million in the case of enterprises established before 1974 or the equivalent of $1.6 million for companies established after January 1, 1974; (b) Tourism services within the same asset limits, except that the net book value of buildings will be counted as part of fixed assets, and (c) Tourist accommodations with a maximum of 200 rooms and a maximum value per room equivalent to $25,000.

Borrower: Banco Industrial S.A.

Loan: $7.0 million ($6.0 million from the FSO and $1.0 million equivalent from the Swiss Fund), 25 years at 2 percent per annum. Total project cost is $9.5 million.

Purpose and Benefits: The purpose of this program is to foster development of industry and tourism in Bolivia by granting credits through the Banco Industria, S.A. (BISA) to finance the establishment, expansion and/or improvement of private firms in the industrial and tour-

BOLIVIA—Continued

ism sectors and, when necessary, to finance technical assistance required for successful operation of these projects. In addition, technical cooperation will be made available for a consultant to organize BISA's internal audit unit and prepare operating manuals.

Bolivia's industrial sector is still in an incipient stage of development, although it accounts for 14 percent of the gross domestic product. The level of investment in the sector is low, the market is insufficient to accommodate major economies of scale, and production techniques are not advanced. Production is oriented toward import substitution and depends heavily on imported inputs; imports of intermediate goods accounted in 1973 for more than a fourth of the value of the industrial product. Exports of industrial products are small. Industry is concentrated in La Paz, Cochabamba and Santa Cruz. The tourism sector is characterized by a high concentration of foreign visitors to La Paz, a scarcity of adequate accommodations and services for tourists, high average daily spending ($35 per visitor) but a short average stay (5 days). Only 3.6 percent of the foreign tourists travelling to South America in 1974 visited Bolivia.

Date approved: July 10, 1975 (IDB)

ROADS: The chief objective of this project is to cooperate in the execution of the first phase (La Paz-San Borja) of the Beni highway, part of the national program for integrating the roads in this Department into the national highway network. The La Paz-San Borja highway has three sections: (i) La Paz-Cotapata; (ii) Cotapata-Alto Beni River; and (iii) Alto Beni River-San Borja. The highway will be built in two stages, keyed to financial resource availabilities. The first stage of the highway will include: (1) reconstruction of the 43.2 kilometer La Paz-Cotapata section; (2) construction of an all-weather 142 kilometer section between the Alto Beni River and San Borja; and (3) construction of three major bridges and 16 minor bridges. The second stage is to comprise: (1) reconstruction of the Cotapata-Alto Beni section; and (2) improve the Alto Beni River-San Borja section (to be built during the first stage) and extend it to Puerto Salinas where the Beni River is navigable.

Borrower: Republic of Bolivia.

Loan: $45 million from the Fund for Special Operations, 40 years at 1 percent per annum the first 10 years and 2 percent thereafter. Total project cost is $56.0 million.

Purpose and Benefits: Bolivia has 37,300 kilometers of highways and roads, of which less than 4 percent is asphalt-paved. The process of building the basic road infrastructure needed to link up the various regions of the country is under way. The proposed highway will be part of this basic network. The project zone of influence embraces approximately 100,000 square kilometers in two sharply contrasting regions: (i) the Yunga region consisting of valleys running east to west in the eastern mountain range with a wide variety of topography and climates which permit agricultural development and where the roads are in a stage of intensive developing owing to rapid colonization, and (ii) the level Beni region, extending east and north from the Beni River, which is covered with forests and natural grassland. Most of Bolivia's cattle-raising is concentrated in this region (more than 1,000,000 head of cattle) and there is considerable unexploited potential. The terminal point of the highway (San Borja) is centered in areas of the greatest development of cattle-raising.

Date approved: November 6, 1975 (IDB)

AGRICULTURE: The resources of this loan will be used to help: (a) establish basic physical infrastructure, including: (i) construction and equipping, in Cochabamba, of the central office of the National Program for Control of Foot-and-Mouth Disease, Rabies and Brucellosis (PRONARB), the Central Diagnosis and Reference Laboratory and other facilities; (ii) construction of and equipping, a regional technical and administrative office and supplementary facilities in Santa Cruz; (iii) construction and equipping 12 veterinary services centers in the project area and two border quarantine stations; and (iv) expansion and equipping of the existing INBA I laboratory to enable it to produce vaccines; (b) procure necessary equipment and vehicles for execution of the project; and (c) import foot-and-mouth disease vaccine and rabies vaccines.

Borrower: Republic of Bolivia.

Loan: $4.2 million from the Fund for Special Operations; 40 years at 1 percent for the first 10 years and 2 percent thereafter; $550,000 non-reimbursable technical assistance. Total cost of the project is $7.0 million.

Purpose and Benefits: Foot-and-mouth disease, rabies and brucellosis account for the greatest disease losses in Bolivian cattle herds. The effectiveness of the Livestock Bureau of the Ministry of Rural and Agricultural Affairs (MACA), presently in charge of disease control activities, is limited owing to a shortage of physical and human resources. Despite previous efforts supported by international assistance, including various technical cooperation programs of the UNDP, FAO, PAHO and other agencies, Bolivia's animal health infrastructure is not at the level required to carry out an efficient disease control campaign, since the budget support needed because of the magnitude of the problem has not been forthcoming. The first stage of the proposed campaign will be carried out in the Departments of Cochabamba and Santa Cruz, with a cattle population estimated at 672,000 head in 1972 (28 percent of the national total). The project will: (i) establish institutional, physical and human resources infrastructure making it possible to: (a) produce foot-and-mouth disease vaccines (by the end of the third year) and brucellosis vaccine (from the first year) for the disease control campaign; (b) immunize at least 80 percent of the susceptible cattle in the project area; (c) perform timely diagnoses; (d) prevent further outbreaks; (e) conduct epizootiology studies, collect statistical data and organize evaluation systems; (f) train personnel; (g) conduct a health promotion and education program among cattlemen; (h) coordinate the campaign with the work of other official entities; (i) establish controls over the movement and marketing of cattle; and (j) lay the groundwork for long-term conduct of the campaign and for extending it to the rest of the country.

Date approved: January 29, 1976 (IDB)

POWER: This project involves assistance to the first stage in the development of the Empresa Nacional de Electricidad (ENDE), including: (i) expansion of the Corani Hydroelectric Power Station; (ii) removal from Santa Cruz and installation in Sucre of four ENDE thermoelectric units; (iii) construction and assembly of the high-voltage line for electrical interconnection of the Central and Southern systems; (iv) construction and assembly of two high-voltage lines for transmission of electricity between Vinto-Catavi and Potosi-Punutuma; and (v) expansion of ten transformer substations.

Borrower: Bolivia, ENDE.

Loan: $24.5 million, 1 percent per annum during the first 10 years from the date of the contract and 2 percent per annum thereafter, repayable in 40 years including 10 years grace period. Total project cost is $30.8 million.

Purpose and Benefits: Energy demand projections indicate a need to increase Bolivian generating capacity and supply of electricity substantially during 1977–81. The most economical solution is the projected expansion in the Corani and Santa Isabel stations (with the Santa Isabel station included in a complementary project being financed by the World Bank). Any thermal alternative would be much more costly. The interconnection of the Central and Southern Systems will make it possible to replace about 40 GWH of energy per annum in the Southern System, using the excess energy in the Central System, manifested through the flows of the Corani dam which are now wasted and which, even in years of low water level, are estimated as being equivalent to about 50 GWH. Diversion of the Vinto River will also add about 40 GWH to the system in years of low water levels. This would represent a fuel saving to the Southern System equivalent to US$1.4 million in 1979, declining in subsequent years as demand increases in the Central System. The saving will offer the possibility of exporting fuel in the amount indicated, and would be greater in years of normal or high water levels. Another important economic factor that will stem from the proposed project is the reduction of stand-by installed capacity needs made possible through interconnection of the systems. It is estimated that in 1979 it would be necessary to incorporate an additional 12 MW to capacity if both systems operate separately, i.e., about 30 percent more than what is considered reasonable as reserve power for that year.

Date approved: June 18, 1976 (IDB)

BRAZIL

AGRICULTURE: The proceeds of this loan will be used in financing a program for the economic and social development of small- and medium-scale rural producers and cooperatives. Short-, medium- and long-term credit will be extended on reasonable terms and conditions and coordinated rural extension services and technical assistance will be provided for individual projects.

Borrower: Federative Republic of Brazil, Banco Central do Brazil.

Loan: $40.0 million, 20 years at 4 percent per annum. Total project cost is $80.0 million.

Purpose and Benefits: The program beneficiaries will comprise: (a) small- and medium-scale rural producers whose assets do not exceed 50 times the annual minimum wage, if they are farmers, and 100 times this level, if they are livestock producers (limits respectively equivalent to about $30,000 and $60,000), and (b) cooperatives with no less than 80 percent of their members classified as small- and medium-scale producers. The program is expected to directly benefit about 14,000 producers and it is estimated that 120 subloans will be granted to farming and stockraising cooperatives benefitting about 180,000 members.

Date approved: September 18, 1975 (IDB)

POWER: The Salto Santiago hydroelectric plant is located on the Iguazu River, approximately 45 kilometers upriver from the Salto Osorio hydroelectric plant. The harnessing of water power at Salto Santiago calls for a main rockfill dam with a sloped puddle core, three auxiliary earthwork dams, one spillway, one water intake, penstocks, powerhouse, adduction and discharge channels, control house and four tunnels for river diversion. The spillway crest will be 510 meters high and 1,300 meters long, giving a maximum depth of 80 meters. Total volume of the dam will be 10.5 million cubic meters (including cofferdams). The Iguazu River will be channeled into four concrete-lined diversion tunnels, 13.5 meters in diameter and 220 meters long, which can be closed by reinforced concrete gates lowered by portal cranes. Between the water intake and the powerhouse six penstocks, 7.6 meters in diameter, will be installed, each anchored in concrete blocks. The powerhouse will house six 330-MW generators (four during the first stage) for a total of 2,000 MW.

Borrower: Centrais Electricas do Sul Brasil S.A. (ELECTROSUL).

Loan: $74 million from Ordinary Capital; 20 years at 8 percent. Total cost is $684.5 million.

Purpose and Benefits: The Salto Santiago hydroelectric project is part of the government's program to expand generation capacity to meet projected demand for electricity in the southern and southern/central-western regions of Brazil. Market forecasts indicate cumulative average growth rates of 10.8 percent for the southeastern/west-central region and 11.2 percent for the southern region. The comparable figures for the last five years for the two regions were 12.5 percent and 15.8 percent, respectively. The project is one of the most economic power projects available to Brazil at this time among those that could begin operation by late 1980 or early 1981. Accordingly, Salto Santiago has been given priority over other hydroelectric and nuclear power projects programmed for the southern and southeastern/central-western regions. The project has the lowest investment, operating and maintenance costs (US$541 million) compared to the other two alternatives. Even were coal and fuel oil prices to be cut in half—which is very unlikely—the hydroelectric alternative would still be the most favorable. The internal economic rate of return of the project is 31 percent, with a net present value of $553.7 million using a 12 percent discount rate.

Date approved: September 25, 1975 (IDB)

POWER: The project comprises a 500 KV single-circuit transmission line 375 km long between the Paulo Afonso hydroelectric station and the Camacari substation (line S-5) situated in the vicinity of the city of Salvador, Bahia. The line will use four steel-reinforced aluminum conductors (ACSR) approximately 2.5 centimeters in diameter (636 MCM) per phase, supported by galvanized steel structures.

Borrower: Eletrica do Sao Francisco, Guarantor Republic of Brazil.

Loan: $35 million Ordinary Capital, 15 years at 8 percent per annum; total cost is $67.9 million.

Purpose and Benefits: The region's estimated per capita income is $200 a year, equivalent to only 28 percent of the national average. The State has made special efforts in recent years to develop the Northeast, including the establishment, in 1959, of the Northeast Development Authority to coordinate regional economic and social development. Industrial development has received considerable attention, leading to a sizeable increase in the region's demand for electric power. Companhia Hidro Eletrica do Sao Francisco's (CHESF) Fourth Expansion Plan will benefit the Brazilian Northeast, a region whose per capita consumption of electric power is only 35 per-

BRAZIL—Continued

cent of the national average. This low level of power consumption is a serious obstacle to economic and social growth in the region. The installed capacity to be supplied by the 440 MW system represents 24 percent of total capacity installed by CHESF, which in 1974 amounted to 1,822 MW. The project's contribution to power supply in the region is thus significant and designed to satisfy growing demand for energy by industrial and domestic users and to meet increased per capita consumption resulting from expansion of the energy supply.

Date approved: November 25, 1975 (IDB)

POWER: The project consists of the construction of a dam, powerhouse and step-up substation on the Iguacu River. The dam will be concrete-face rockfill, 800 m long and 153 m high, and will create a reservoir 110 km long with a surface of 197 km² and a volume of 7.3 billion m³. The powerhouse will be built to contain six 375 MW turbine and generator units (final capacity 2,250 MW). A 500 KV transmission line from Foz do Areia to Curitiba, the main consuming center for the energy to be generated by the plant, will be constructed and operated as part of the extra-high voltage transmission system interconnecting various parts of the southern and southeast/center-west regions of Brazil.

Borrower: Companhia Paranaense de Energia Electrica Guarantor Republica Federativa do Brasil.

Terms: $74 million from Ordinary Capital; 20 years at 8 percent per annum. Total cost: $666.5 million.

Purpose and Benefits: Paraná has an area of about 200,000 km² and a population of 8,200,000. Coffee, cotton and soybean production still occupy leading positions in the economy, but the industrial sector, especially wood, textiles and food, has expanded rapidly during the last decade and has been a major contributor to the 12.1 percent annual rate of growth of electric energy consumption (845 kwh in 1963 vs. 2,577 kwh in 1974).

Although the energy to be generated by the Foz do Areia power plant will be consumed entirely in Paraná, the plant is an integral part of the Federal Government's program to meet future energy requirements in the combined south and south-east/center-west regions, which are to be interconnected after 1980 by a system of 500 KV and 760 KV transmission lines. These lines will be used to transmit energy to the south-east/center-west region—basically the São Paulo area—where a shortage of dependable energy is expected in 1981 which will continue until the first units of the Itaipu installations come on stream in 1983.

Date approved: December 11, 1975 (IDB)

EDUCATION: The program to be assisted by this loan includes assistance to the Federal Universities of Bahia, Brasilia, Espirito Santo, Pará, Paraiba, Rio Grande do Norte and Sergipe, all located in the lesser developed regions of Brazil.

Investments are contemplated in expanding the teaching staff working fulltime, training teaching personnel, contracting technical consultants, procuring laboratory equipment, teaching material, furniture, books and publications, and constructing buildings for classrooms, laboratories, administration, general services and infrastructure facilities.

Borrower: Federal Republic of Brasil.

Terms: $20 million from Ordinary Capital, 30 years at 8 percent per annum. $30 million US equivalent in Brazilian cruzeiros from the Fund for Special Operations; 30 years at 3 percent per annum. Total cost: $150 million.

Purpose and Benefits: The purpose of the program is to contribute towards the achievement of the goals of university reform in Brazil, providing the selected universities with the means necessary for improving the quality and efficiency of higher education and expanding teaching functions, research and university extension, in order to provide professional staff in sufficient quantity and with proper training to meet labor market needs in a situation of rapid economic growth.

Until a few years ago, the higher education system in Brazil reached but a very small fraction of the population (2.5 students for every 1,000 inhabitants in 1967) and was limited to offering a restricted range of traditional professional careers, with little impact on the intensified economic and social development process Brazil undertook beginning in the decade of the 1960's. One of the goals of this project is to ameliorate this shortcoming of the educational system.

Date approved: December 18, 1975 (IDB)

CHILE

URBAN DEVELOPMENT: The program to be financed with this loan is part of Chile's housing plan to improve living conditions for approximately 16,300 low-income families living in 17 marginal urban communities or "camps" in Santiago and Concepcion. The project will improve urban infrastructure and social and community services for existing housing and units will be built to minimum acceptable standards. The urban infrastructure facilities to be provided for this purpose will be those needed to: (i) provide the housing developments with adequate water supply per capita and necessary sewerage and storm drainage service; (ii) provide streets for bus and car access and walkways to the principal and secondary streets; and (iii) supply necessary electric power service. The essential community services in the program will be aimed at providing sufficient schools for the basic education of all primary-school age children. The community services component of the program has as its goals: (i) providing kindergartens for all pre-school age children of working mothers; and (ii) constructing centers for essential commercial activities.

Borrower: Republic of Chile.

Loan: $25.2 million from the Fund for Special Operations, 30 years at 2 percent per annum. Total project cost: $45.8 million.

Purpose and Benefits: Chilean Government housing policy sets forth basic guidelines for a public works plan designed to provide housing, urban infrastructure and essential social and community services in the near future for the benefit of low-income earners. The policy is based on the following premises: (i) housing is a fundamental factor in social development; and (ii) is a right to be earned by the citizen, preferably through savings, with state subsidies to be employed only in cases of obvious need. In line with this policy the public works plan for which the Ministry of Housing and Urban Development has responsibility is designed to: (i) give priority, in the short and medium run, to construction of housing of social interest; (ii) help eradicate extreme poverty through a construction program to eliminate slums (estimated to contain some 140,000 families) within approximately five years; (iii) provide, along with the housing built, such essential social and community services as schools, kindergartens, shopping centers, etc.; and (iv) carry out a continuing program of community education while the housing is being constructed.

Date approved: December 11, 1975 (IDB)

COLOMBIA

DEVELOPMENT FINANCE: This program is designed to achieve several important objectives: (a) to support the Government's export expansion and industrial decentralization policies, and improve access by medium-sized firms to resources of the international financial institutions; (b) to intensify the Financieras' efforts in mobilizing domestic resources, and strengthen their developmental impact; and, (c) to further build up the capacity and increase the effectiveness of the Department of Development Credit (Departamento de Crédito de Fomento) of the Banco de la Republica for supervising Financieras, reviewing appraisals of investment projects, and allocating scarce development funds efficiently.

Borrower: Banco de la Republica of Colombia, Guarantor, Republic of Colombia.

Terms: $30 million from Ordinary Capital at 8 percent per annum for 17 years. Total program cost: $220 million.

Purpose and Benefits: Manufacturing, which contributes about one-fifth of Colombia's GPD, is a leading growth sector. Between 1967 and 1974, manufacturing output rose 9 to 10 percent annually, a rate unmatched since the 1950's. Industrial exports rose from a relatively low level in 1967 to US $380 million in 1974, representing over 7 percent of industrial output, and made an important contribution to industrial growth. This export expansion has been characterized by a remarkable diversification in the range of goods exported and a continued geographical diversification of trade. Exports to Latin American, and particularly to Andean Group countries, have increased very rapidly.

Combined project lists of the seven major Corporaciones Financieras which will serve as intermediary financial institutions in the proposed program indicate a potential requirement for US $230 million over the next two to three years to finance the foreign exchange component of fixed investments by their clients.

Date approved: December 18, 1975 (IDB)

TRANSPORTATION: The program which this loan will help finance comprises the following projects: (i) construction of a second roadway of the Cali-Palmira section of the East Trunk Highway, including the bridge over the Cauca River; (ii) construction of the Las Pavas Bypass between San Roque and Bosconia and improvement of the km 55-San Roque and Bosconia-Fundacion sections on the East Trunk Highway; (iii) improvement of the Villavicencio-Puerto Lopez highway; (iv) improvement of the Guadalupe-Florencia highway; (v) construction of the Puerto Rico-San Vicente del Caguan highway, with a bridge over the Guayas River; and (vi) connection of the Caribbean Trunk Highway with the bridge over the Magdalena River at Barranquilla. The program is generally designed to strengthen Colombia's basic highway network. Four of the six projects included are designed additionally to build up or improve access to areas which have a high potential for agricultural production and where farming is at varying stages of development.

Borrower: Republic of Colombia.

Loan: $11 million from Ordinary Capital; 20 years at 8 percent per annum, $34.8 million from FSO, 30 years at 2 percent per annum. Total cost: $91.6 million.

Purpose and Benefits: Colombia's mountainous topography, together with the location of principal centers of economic activity and the geographic distribution of population, has led to the development of two major transport corridors in the country. Both run roughly from north to south, following the Magdalena and Cauca Valleys along major portions of their length. The two systems are connected at various points and branch into roads providing access to the Pacific coastal region, the eastern plains and the Amazon region. Bulky, homogeneous, long-distance cargo is carried by river boat and railroad, while most short- or medium-distance cargo is moved by truck. Exceptions are explained by such specific circumstances as the absence or low quality of one or more transport modes in a given region or city. Colombia's topographical and geographic problems encouraged the development of somewhat isolated regional economies. The desire for national integration, with emphasis on overland connections, has led to the rapid development of the transport infrastructure, with primary emphasis given in recent decades to completion of the system of main roads. The completion of this highway project will further serve to integrate relatively isolated areas into the national economy.

Date approved: December 18, 1975 (IDB)

COSTA RICA

HEALTH: The proceeds of this loan will be used to help finance a project for improving preventive and curative medical care and rehabilitation services in rural areas. The project also includes $284,610 in non-reimbursable technical cooperation for institutional strengthening of Costa Rica's Social Security Institute.

Borrower: Republic of Costa Rica.

Loan: $20 million, 35 years at 2 percent per annum. Total project cost is $28.0 million.

Purpose and Benefits: The project involves construction of, and equipping, three hospitals, three maternal and child care clinics, and twelve outpatient clinics as part of a program to expand the Social Security Institute's capabilities to satisfy demand for health services in peripheral regions. The new facilities will provide for approximately 590 beds plus outpatient services in rural areas outside the Central Region (where existing health facilities are now concentrated). The technical cooperation component of the project will finance fellowships for relevant studies abroad, hiring a PAHO expert and a consulting firm specialized in finance and accounting.

Date approved: September 18, 1975 (IDB)

DEVELOPMENT FINANCE: The Banco de Costa Rica (BCR) will use these loan resources to grant credits on medium- and long-term to small- and medium-scale industrial producers in the private sector.

The IDB resources would be used exclusively to finance the external costs of the program, including procurement of machinery, equipment and tools, and construction, assembly and installation of industrial plants. BCR's contribution to the financing of the program would be used to cover part of the demand for working capital for development projects, the local costs of building and assembling industrial plants, and other local costs.

Borrower: Banco de Costa Rica. *Guarantor:* Republic of Costa Rica.

Terms: $5 million from Ordinary Capital, 20 years at 8 percent per annum. $3 million from the Fund for Special Operations, 20 years at 2 percent per annum. Total cost: $12.0 million.

COSTA RICA—Continued

Purpose and Benefits: The program will be directed to fostering the establishment, expansion and improvement of small- and medium-scale industrial firms in the private sector through the financing of economically profitable projects which would help to: (i) achieve maximum utilization of natural resources; (ii) increase employment through labor-intensive industries; and (iii) improve the private sector's production structure with a view to replacing imports and increasing exports of manufactured goods.

The potential demand for credits of this type is estimated at about US$100 million during the three years of the 1975–1978 program. Based on BCR's past participation in the supply of industrial credit in Costa Rica (about 50 percent), it is anticipated that the BCR will be able to place all the resources of the program plus recoveries from earlier loans, which are estimated at US $4,500,000.

Date approved: December 11, 1975 (IDB)

RURAL ELECTRIFICATION: This project will install and/or construct over a four-year period more than 1,058 kilometers of distribution lines; 73 kilometers of distribution systems; 10 receiver substations, distribution transformers for the equivalent of 16,720 KVA with the corresponding 240/120 V secondary lines to accommodate the 16,720 connections and meters; 15 small diesel generating units totalling 3,500 kW and 11 buildings to house Instituto Costarricense de Electricidad (ICE) agencies. In addition, vehicles, high tension line, tools and other maintenance equipment are to be procured. The project has been divided into seven subprojects according to the zones of influence, designated as: (a) Isolated Systems; (b) Pacific Zone; (c) Central Zone; (d) Atlantic Zone; (e) COOPEGUANACASTE; (f) COOPELESCA and (g) COOPESANTOS. The first four subprojects will be executed by ICE and the others by the cooperatives indicated.

Borrower: Republic of Costa Rica.

Loan: $13.5 million from the FSO; 35 years at 2 percent per annum. Total project cost, $19.5 million.

Purpose and Benefits: The aim of this project is to supply electric power to 16,720 new subscribers. This will benefit a rural population of about 90,000 in rural areas where service now is deficient and intermittent. ICE will endeavor to alleviate this situation through gradual and systematic implementation of a rural electrification program enabling it to provide adequate electric service to 90 percent of the rural population by the end of this century. This project is the first stage of that program.

Date approved: January 22, 1976 (IDB)

DOMINICAN REPUBLIC

INDUSTRIAL CREDIT: These Bank loan proceeds will be limited to financing the purchase of machinery, equipment, spare parts and materials of external origin which will form part of the fixed assets of industrial enterprise projects. The local currency component of the loan is to finance some construction and equipment of local origin. The local contribution resources would be used to finance part of the expenditures for the acquisition of fixed assets and working capital.

Borrower: Banco Central de la Republica Dominicana, Guarantor, Dominican Republic.

Loans: $7.0 million from FSO, 40 years at 1 percent per annum for the first 10 years, 2 percent per annum thereafter, 7.95 million Swiss Francs from the Swiss Development Fund for Latin America; 40 years at 1 percent per annum for the first 10 years, 2 percent per annum thereafter. Total project cost is $13.5 million.

Purpose and Benefits: The industrial sector in the Dominican Republic has exhibited the most dynamic growth of any sector of the economy in recent years with its share in the gross domestic product increasing from 14.5 percent in 1968 to 17.7 percent in 1974. Production is centered on the manufacture of perishable goods and consumer goods, although some of these traditional industrial lines have begun to lose relative importance. Exports of manufactured products rose at an annual 19 percent rate during 1968–74, and imports of raw materials and intermediate goods expanded at an annual rate of 19.6 percent, reflecting high sectoral dependence on imports. The Credit Program for Development of Small- and Medium-Scale Industry supports the Dominican Government's national development objectives and policies, which call for increasing industrial investment so as to improve the utilization of the abundant supply of manpower and domestic raw materials, and decentralize economic activity.

Date approved: January 22, 1976 (IDB)

ECUADOR

TRANSPORTATION: This project calls for helping to finance the following works in the Loja-Velacruz-Saracay road system: (a) Loja-La Toma: construction of an alternate route approximately 34 kilometers long paved with bituminous concrete; (b) La Toma-Las Chinchas-Velacruz (approximately 41 km): improvement in the alignment, altimetry and width, and paving by means of a dual bituminous treatment; (c) Velacruz-Saracay (approximately 115 km): construction of base and paving with dual bituminous treatment.

Borrower: The Republic of Ecuador, Ministerio de Obras Publicas y Communicaciones.

Loan: $11.1 million from Ordinary Capital; 20 years at 8 percent per annum. Total cost: $20.0 million.

Purpose and Benefits: The primary objective of the project is to provide the provinces of Loja and Zamora-Chinchipe with adequate overland transportation to permit: (a) better access of both provinces to Ecuador's principal markets; and (b) better integration of the area's population with the rest of the country. Particular attention was paid in the project analysis to the determination of users' savings which the project would generate, as well as the estimate of economic feasibility. The internal rates of return are estimated to be 15.9 percent for the program as a whole and at 13.3 percent, 13.2 percent and 23.2 percent for the Loja-La Toma, La Toma-Velacruz and Velacruz-Saracay sections, respectively. Completion of the Loja-Velacruz-Saracay project will reduce the time needed to go from the province of Loja to the principal urban centers of the country substantially. Savings in time are estimated to be 50 percent.

Date approved: July 31, 1975 (IDB)

GUATEMALA

EDUCATION: This project will help provide the Instituto Technico de Capacitacion y Productividad (INTECAP) with the physical installations, equipment and personnel needed to expand its activities. This includes: (a) construction of six training centers and a building to house central offices; (b) expansion and additional training of teaching staff; (c) equipping of workshops and laboratories and provision of teaching materials for the centers; and (d) technical cooperation to improve INTECAP's planning and administration work, as regards both teaching, organization and methods, including financial management.

Borrower: Republic of Guatemala.

Loan: $8.6 million from FSO, 40 years at 1 percent per annum for the first 10 years and 2 percent thereafter, 10½ years grace period, $375,000 is nonreimbursable technical assistance. Total project cost is $10.7 million.

Purpose and Benefits: The project is designed to further the worker training goals of the National Economic Planning Council, which call for achieving a 25-percent increase in the number of skilled workers between 1975 and 1980. INTECAP is one of the key Guatemalan institutions conducting job-oriented workers' training and non-formal education activities for adults in direct association with employing firms for the purpose of training semi-skilled and skilled workers and middle-level and executive management personnel.

Date approved: October 16, 1975 (IDB)

WATER SUPPLY: The objective of this project is to supply potable water, through the construction of 105 water supply systems, to a rural population of approximately 83,000 at present, 93,000 at the end of the period of execution (1979), and 134,000 by the end of the design period of the systems (1994). This population is distributed in about 200 communities in 20 of the 22 Departments of Guatemala. The water supply systems to be built consist basically of simple integrated facilities for catchment, conduction, treatment (in a few cases), regulation and distribution of potable water. Most of the systems operate by gravity. The supply of water per person per day will be 60 to 80 liters, depending on the specific needs of each community. The water-courses used are to have quality and flow characteristics to make it possible to provide the minimum required supply in each instance.

Borrower: Republic of Guatemala.

Loan: $7.0 million from the Fund for Special Operations, $220,000 nonreimbursable technical cooperation, 40 years at 1 percent per annum for the first 10 years and 2 percent thereafter. Total project cost is $9.6 million.

Purpose and Benefits: Health conditions in Guatemala are considered to be among the poorest in the hemisphere. Life expectancy at birth is approximately 53 years, or 11 years less than the average for the rest of Latin America. Indexes of general mortality and infant mortality are also among the highest in the region. The leading causes of morbidity and mortality are poor environmental conditions, especially those related to inadequate water supplies. The incidence of water-borne diseases is much higher in the rural sector, which includes almost 65 percent of the national population. In order to help alleviate this problem the 1975–79 National Development Plan calls for adequate assistance to the rural sector through health and education programs, among which construction of rural water supply systems has high priority. The criteria to be followed for the selection of beneficiary communities include basic social and economic conditions, in order to ensure social equity by providing potable water to communities with the highest concentration of population now lacking this service and to ensure efficiency by giving priority to the lowest-cost projects, taking into account the amount of the investment as well as the cost of operation and maintenance per beneficiary.

Date approved: November 6, 1975 (IDB)

POWER: This project involves: (i) a rockfill dam at Pueblo Viejo; (ii) a spillway; (iii) a power tunnel approximately 26 kilometers long; (iv) a plant at Quixal with a powerhouse having a total capacity of 200 MW; and (v) a transmission line from the plant to Guatemala City, approximately 120 kilometers long.

The project site is in Central Guatemala, approximately 80 kilometers from Guatemala City, in a mountainous region with elevations ranging from 300 to 3,000 meters. In the project area the Chixoy River drops about 400 meters, which will be taken advantage of to build a dam to store 424 million cubic meters of water.

Borrower: Republic of Guatemala.

Terms: $45 million from the Fund for Special Operations, 40 years at 1 percent per annum for the first 10 years and 2 percent thereafter. US$36 million and Bs. 38.7 million from the Venezuelan Trust Fund, 25 years at 8 percent per annum. $10 million loan, 25 years at 8 percent and $15 million renewable supplementary line of credit from Ordinary Capital. Total cost: $340.9 million.

Purpose and Benefits: The purpose of the project is to expand the generating capacity of the Guatemalan power system through construction of a hydroelectric plant in the middle reaches of the Chixoy River with a capacity of 300 MW to be installed and an average energy production capacity of 1,650 GWH per year.

The project, which has been given top priority in the Guatemalan 1975–1985 energy development program, is designed to achieve the national goal of reducing the effects of the high cost of thermogeneration on the economy of the country, which has to import all of its fuel requirements. The power plant should be in service in 1982 if deficits are to be avoided in subsequent years. The best alternative is the proposed hydroelectric plant where it will be possible to start construction as soon as the bidding process is completed.

Date approved: December 18, 1975 (IDB)

AGRICULTURAL CREDIT: This project consists basically of two sub-programs, both of which are designed to benefit small- and medium-scale farmers organized into cooperatives or acting as individuals. *Subprogram A:* Consists of granting short-, medium-, and long-term credits to individual farmers. *Subprogram B:* Consists of providing finance to cooperatives and other authorized rural entities for the execution of small agro-industrial projects, installation of storage centers, and extension of credit to members. The program will be executed by the Banco Nacional de Desarrollo Agricola (BANDESA) using resources from this loan plus local contributions.

Borrower: Republic of Guatemala.

Loan: $15 million from FSO, 40 years at 1 percent per annum for the first 10 years, 2 percent per annum thereafter. Total cost is $21.0 million.

Purpose and Benefits: Guatemala is pursuing a development policy aimed at helping small- and medium-scale farmers by means of a specific program of technical assistance and credit to increase production of basic crops and diversify into other crops to the extent possible. The establishment (December 1970) of the Banco Nacional de Desarrollo Agricola (BANDESA) put a single parastatal agency in charge of coordinating public credit and financial activities for agricultural development in Guatemala.

GUATEMALA—Continued

Trust funds have been created using public resources and contributions from external loans and turned over to BANDESA for administration. Operations with these funds are governed by special rules designed to facilitate granting loans to small- and medium-scale farmers who are unable to qualify for loans from commercial banks.

Date approved: January 15, 1976 (IDB)

INDUSTRIAL AND TOURISM CREDIT: The Corporacion Financiera Nacional (CORFINA) will use these loan proceeds to grant medium- and long-term credits to private companies engaged in industry and tourism to help finance expansion of facilities, including the construction of new, and additions to existing, industrial plants and hotels, and the purchase of needed machinery and equipment.

Borrower: Republic of Guatemala.

Loan: $7.0 million from the Fund for Special Operations, 40 years at 1 percent per annum for the first 10 years, 2 percent thereafter. Total project cost is $9.0 million.

Purpose and Benefits: Guatemalan industry is characterized by a predominance of small units producing goods basically oriented toward the domestic market. These firms are typically under-capitalized, use antiquated production techniques and are quite often prevented from making large-scale economies through the expansion of fixed facilities because of the insufficient size of the local market. To meet estimated requirements the tourism sector will need to increase available hotel space by about 4,000 rooms over the present level (estimated at 3,535 rooms). Using an average cost of US$18,000 per room, fixed investment in this sector will need to increase by some US$72 million over the next three to four years. This IDB loan will help, in part, to meet those capital needs.

Date approved: February 5, 1976 (IDB)

HEALTH: This project involves construction and equipping of the following health services: (a) 3 integrated health centers, each with 100 beds and an area of approximately 3,122 square meters; (b) 2 type (A) integrated centers, each with 50 beds and an area of approximately 3,120 square meters; (c) 7 type (A) health centers, each with 30 beds and an area of approximately 2,774 square meters; (d) 46 type (B) health centers, each with six beds and an area of approximately 160 square meters each; and (f) 4 maintenance shops with an area of 165 square meters each. The project also calls for procurement of equipment, medical and surgical instruments and vehicles relating to the various components of the project. Nonreimbursable technical cooperation will also be furnished by the Bank.

Borrower: Republic of Guatemala.

Loan: $28.0 million equivalent from the Fund for Special Operations, 40 years at 1 percent for the first ten years, 2 percent thereafter. Total project cost is $32.6 million.

Purpose and Benefits: This project is aimed primarily at improving health care in Guatemala through constructing and equipping health services to be located mainly in rural areas. These rural areas include those most seriously affected by the violent earthquake of February 4, 1976. The Government of Guatemala requested the Bank to send a special mission to examine possible changes in the project as a consequence of earthquake damage.

Date approved: June 18, 1976 (IDB)

HAITI

TRANSPORTATION: These supplemental loan funds will help finance cost overruns and other modifications to an earlier port project including: (a) reinforcing the basic structure of a pier to support the container crane; (b) purchasing and installing a traveling crane of 80,000 pounds capacity to handle container freight (rather than the previously planned truck crane); (c) making necessary adjustments in mobile equipment so that container cargo can be handled in the port terminal, and (d) adding a platform for roll-on roll-off container cargo handling.

Borrower: Banque Nacionale de la Republique d'Haiti (BNRH) Administration Portuarie de Port-au-Prince (APP).

Loan: $7.5 million, 40 years at 2 percent per annum. Total project cost is $20.8 million.

Purpose and Benefits: The original economic analysis (1972) was based on a simplified assumption which did not include time-saving for vessels in the benefits of this project. Owing to the expected limited capacity of the port without the project, benefits in the form of savings in cargo handling costs were considered sufficient to justify the project. The efficiency of the port and, accordingly its capacity, have, however, risen during the intervening three years as a result of the use of containers for half the cargo. Moreover, the volume of cargo increased 78 percent, compared to the 27 percent growth predicted three years ago. These circumstances, affecting both benefits and costs, made it necessary to re-do the economic analysis of the project including retention by Haiti of 80 percent of ship time-saving owing to shorter layovers because of more efficient cargo handling and reduced waiting time. If this value were 65 percent, the present worth of these benefits to Haiti would drop to $9.0 million and the internal rate of return would be 10.1 percent. The estimate of the internal rate of return is 11.4 percent. If the benefits deriving from savings in labor cost as a result of mechanization of operations is excluded—in view of unemployment and under-employment in Haiti—the internal rate of return of the project is 10.4 percent.

Date approved: September 11, 1975 (IDB)

TRANSPORTATION: This project consists of completing the Southern Highway (Route No. 200) section between Aquin and Les Cayes including a bridge over the Momance River. The works projected include construction of a two lane highway approximately 59 km in length.

Borrower: Banque Nationale de la Republique de Haiti, Secretariat for Public Works, Transport and Communications.

Loan: $25.0 million, 40 years at 1 percent per annum for the first ten years and 2 percent thereafter. Total project cost is $29.0 million.

Purpose and Benefits: The revised internal rate of return for the Southern Highway, based on a quantification of direct benefits, is estimated to be 10.2 percent or slightly above the 10.1 percent rate estimated in the original project evaluation. There are some additional and substantial indirect benefits including a favorable impact on the balance of payments, stimulation of farm production, opportunities for tourist development, and incorporation of large areas of subsistence type farming into the market economy. On the basis of the quantifiable benefits, the road between Aquin and Les Cayes has an internal rate of return of only 7 percent. This estimate, however, is conservative because there is insufficient information on the road's effect on increasing the production of high economic value crops such as coffee and sugar cane, and any consequent generation of additional traffic. Furthermore, information is unavailable on bus traffic, likely increases in tourist arrivals, or stimulation of any other agro-industrial production. It is highly probable that additional investments in agriculture will result from this road investment, thereby increasing the flow of benefits from the additional traffic.

Date approved: October 16, 1975 (IDB)

HEALTH: This project covers a portion of the national plan for expanding health service coverage which consists of establishing 6 health regions to replace the current 11 health districts in Haiti. The program will start with the first stage in the northern and southern regions and will cover the important cities in both regions as well as most localities with more than 400 population. The present population of the two regions is estimated at about 1.7 million persons with deficient health service coverage. It is estimated that outpatient contacts will increase 55 percent, from 521,000 in 1973 to 810,000 in 1980 as a result of this project.

Borrower: Banque Nationale de la Republique d'Haiti, Guarantor, Republic of Haiti.

Loan: $6.3 million from FSO, 40 years at 1 percent per annum for the first 10 years and 2 percent per annum thereafter, $442,000 for nonreimbursable technical cooperation. Total cost of the project is $7.3 million.

Purpose and Benefits: The health of Haiti's population is one of the poorest in Latin America, as indicated by the general mortality and infant mortality rates (16.9 per 1,000 persons and 138 per 1,000 persons, respectively). The chief reason for this serious situation is deficient food intake, especially among children, and the insufficient coverage of health services, particularly in rural areas. It is expected that the program's package of components will expand the coverage and raise the quality and efficiency of health services in the two regions. Projected improvements in quality stem from the new dispensaries and clinics which will draw on skilled personnel from the new training centers. The modernized administrative structure will ensure better distribution and a larger amount of equipment, personnel and medicine consistent with needs. Greater efficiency is expected primarily in the hospitals and the health centers through increased use of beds and a drop in the average length of stay of each patient.

Date approved: November 13, 1975 (IDB)

HONDURAS

HEALTH: The program to be financed with these loan funds includes the following health services: (1) Approximately 243 Rural Health Centers (Centros de Salud Rural—CESAR); the CESARES are to provide basic diagnostic services and will attend in particular to mothers and children, handling pregnancies and referring women to the pertinent CHE (Emergency Hospital Center). These services are to be distributed throughout the country (except in the metropolitan area of the capital city) in accordance with the regional pattern designed by the Ministry of Health. (2) Eight Emergency Hospital Centers (Centros Hospitalarios de Emergencia (CHE)) which will comprise an out-patient section; a public health section; an emergency section with all essential services, including rehydration of children; diagnostic services (laboratory, radiology and others); and hospitalization, broken down into medical services, surgery, maternity and pediatrics, a pharmacy and the pertinent administrative support services. The CHEs will have 50 beds each. (3) Two Regional Hospitals, one to be built in Comayagua and the other in San Pedro Sula.

Borrower: Republic of Honduras.

Loan: $11.5 million from FSO, 40 years at 2 percent per annum, grace period of 10½ years. $2.5 million from Norwegian Fund, 30 years at 2 percent per annum, grace period 7½ years, $465,000 nonreimbursable technical assistance. Total project cost is $16.3 million.

Purpose and Benefits: The main objective of the program is to increase coverage of basic preventive and curative medical services to promote, protect and restore health, particularly in rural areas. The pyramid of health services planned under the program will cover about 85 percent of the rural population. Direct medical care will benefit approximately 780,000 persons and indirect medical care about 800,000 persons. These services are to be distributed throughout Honduras in properly located areas, according to pre-established selection criteria.

Date approved: October 16, 1975 (IDB)

TELECOMMUNICATIONS: The portion of the project to be financed with this Bank loan consists of: (a) modernization and expansion of telephone service in San Pedro Sula through installation of new outside plant with a capacity for approximately 20,000 pairs of wires, (b) modernization and expansion of telephone service in Tegucigalpa through expansion of outside plant with a capacity of approximately 26,000 pairs of wires, (c) expansion of telephone service in Olanchito and Juticalpa through installation of 400 pairs of wires in each city, (d) improvement of telecommunications services in Honduras through the strengthening of administrative, accounting and operational capability of the national telecommunications system and training of staff.

Borrower: Republic of Honduras.

Loan: $14.7 million from the Fund for Special Operations, 40 years at 1 percent per annum for the first ten years and 2 percent thereafter. Total cost $34.2 million.

Purpose and Benefits: The main objective of this project is improvement and expansion of telecommunications services in Honduras through expansion and modernization of the inside and outside plants of the telephone service in San Pedro Sula, Tegucigalpa and other major cities and expansion of long distance and rural service. Institutional, operational and administrative strengthening of the national telecommunications system will also be undertaken.

Date approved: December 18, 1975 (IDB)

JAMAICA

POWER: The proceeds from this loan will help to: install 160 primary distribution branch power lines totalling approximately 640 miles; install rural-type low-voltage transformer stations to service users or groups of users through a 220/110V secondary distribution system with an estimated length of 480 miles. Within this total, 380 miles will be installed on the posts of the primary lines and 100 will be secondary distribution lines. Provision will also be made for carrying out a program of financial assistance for an estimated 5,000 house installations, or about 70 percent of the users for whom con-

JAMAICA—Continued

nections are to be made during the four-year execution period of the project.

Borrower: Jamaica.

Loan: $9.2 million from the Fund for Special Operations, 35 years at 2 percent per annum. Total cost is $13.7 million.

Purpose and Benefits: The benefits of this project are varied and include: (a) the provision of rural electrification in conjunction with other programs underway in the zones of project influence (feeder roads, land leasing, agricultural credit, employment and school construction program and literacy program); (b) improved distribution of income by channelling funds toward rural areas; (c) realization of user savings through a less costly source of energy; (d) the reciprocal interaction among a number of economic and social development programs. The availability of electricity will have a significant impact on education and health by permitting the use of modern procedures for broadcast programs of training and allowing more efficient execution of nutrition and family planning programs. According to a sample survey, 5 percent of prospective users would utilize energy to increase agricultural and livestock production and over 20 percent for refrigeration.

Date approved: October 30, 1975 (IDB)

WATER SUPPLY: The project calls for: (a) construction of a new water production and transmission system to increase flows by some 7.5 MIGD; (b) improvement of the primary distribution network of the Montego Bay system; (c) extension of the secondary distribution network of Montego Bay and establishment of the fund for house connections in Montego Bay and Falmouth; and (d) conduct of investigations for protection of sources and control of leakage. Simultaneous with execution of the project, and independent of it, nonreimbursable technical cooperation is to be provided for hiring consultants to do a comparative study with a view to establishing the bases to enable the Jamaican Government to determine the appropriate entity (NWA and/or the Parish Councils) to administer and operate the Montego Bay and Falmouth water distribution systems and propose a suitable schedule of tariffs to cover the operating costs of this project.

Borrower: Jamaica.

Loan: Total IDB: $12.0 million equivalent; $6.1 million from FSO, 35 years at 2 percent per annum, $5.9 million from Ordinary Capital, 20 years at 8 percent per annum. Total project cost $20.0 million.

Purpose and Benefits: The project will be carried out in the parishes of St. James and Trelawny on the northwest coast of Jamaica and will serve primarily the urban areas of Montego Bay and Falmouth in these parishes. The project area of influence is a long, narrow strip of land (approximately 35 miles long, with a width ranging from 1.5 to 2 miles), which has an estimated population of about 78,000. It is estimated that by 1990 (project design year) the population being served would be about 118,000. The incomes of the population in the project area are far below other parts of the country, especially in Kingston where the highest level for 80 percent of the families in 1972 was equivalent to US$5,040, compared with US$3,150 in Montego Bay. This situation is exacerbated by an area rate of unemployment higher than the average for the country as a whole. The condition of the water supply service in the project area, as well as the crowded conditions in which the people live, are further indicators of the disadvantaged situation of the population living within the confines of the two parishes which are to benefit from the project.

Date approved: December 4, 1975 (IDB)

EDUCATION: This project will provide partial financing for continuing operation of the Students' Loan Fund which authorizes subloans at concessional terms to Jamaican students from families with limited financial resources. The subloans are to finance studies at higher and vocational educational levels in priority disciplines.

Borrower: Jamaica.

Loan: $5.9 million from the Fund for Special Operations. 35 years at 2 percent per annum. Total project cost is $9.3 million.

Purpose and Benefits: This human resource development program is designed to encourage students with scant resources to pursue higher and vocational education in areas of study of priority importance to the economic and social development of Jamaica. These repayable resources will serve to alleviate partially the burden being created by gradual reductions in government resources available through the Free Education Programme and by the upward impact of inflationary pressures. In addition to expanding program parameters, including the incorporation of new institutions and priority areas of study, more students will be potentially eligible for financial help under this project.

Date approved: March 18, 1976 (IDB)

MEXICO

TICK CAMPAIGN: The program proposes investments basically in two subprograms: direct investment and credits. The direct investment subprogram comprises investments in engineering and administration, construction, technical inputs, laboratory materials, machinery, equipment and vehicles for establishment and support of the campaign physical infrastructure. The Credits Subprogram calls for granting credits to small-scale stock raisers located in ejidal sectors where, in order to step up the campaign, it will be necessary to install tick dips. Resources also include costs and contingencies during program execution.

Borrower: Nacional Financiera, S.A.

Loan: $35 million, total project cost is $178 million, 20 years at 8 percent per annum.

Purpose and Benefits: The goal of the program is to intensify the National Anti-tick Campaign conducted by the Mexican Government, the ultimate goal being to eliminate losses to Mexican stock raisers caused by this parasite. Program resources will be used to provide the campaign with the technical-administrative, financial and human resources needed for intensive tick eradication and for extending its scope throughout the country.

Date approved: October 2, 1975 (IDB)

RURAL DEVELOPMENT: This program consists in its entirety of specific investments and services to be executed in a coordinated and simultaneous approach in 15 regions of the country. The regions show varying population and ecological characteristics. One factor common to all, however, is the high rate of poverty; the average per capita income is less than US$100 per year. The following types of investments are envisaged: (1) *Irrigation.* Plans call for construction of minimum-size facilities (for livestock water troughs, home use and irrigation) and small-scale facilities that would improve approximately 35,000 hectares and improve the irrigation of an additional 15,000 hectares. (2) *Livestock development*. In *ejido* and rural communities approximately 150 beef cattle, 120 swine, 30 small livestock (sheep, goats, etc.) and 200 bee-keeping units will be established. The basic investments consist of land improvement (clearing); seeding and fertilizing of pasture; construction of barns, fences and handling corrals; installation of watering facilities, dipping vats and scales. (3) *Soil and water conservation*. Construction of ditches, terraces, and ponds and other practices to protect and conserve soil and water resources over an area of approximately 85,000 hectares. (4) *Fruit production*. Establishment of small orchards over an area of approximately 5,800 hectares, including land improvement, supplies of selected plants, hole digging, fertilizing and cultivation during the first year. (5) *Rural industries and handicrafts*. Establishment of small rural industries and handicrafts to take advantage of the labor and raw materials of the regions. Among these industries are brickmaking, development of quarries, fruit and garden produce processing plants, sewing shops and shops for other handicraft operations. (6) *Agricultural and livestock credit*. Medium- and long-term investment and operating capital loans will be provided to *ejidatarios* and small farmers so that they can make better use of investments in productive infrastructure. (7) *Improvement of housing and public spaces*. The provision of materials for the improvement of housing and public open spaces (primarily recreation areas) in *ejidos* and towns. These will be built using self-help and mutual help systems. The total cost of this subprogram will be financed by the local counterpart resources of the program.

Borrower: Nacional Financiera, S.A. Guarantor, United States of Mexico.

Loan: $20 million from Ordinary Capital, 25 years at 8 percent per annum, 4½ years grace period. $20 million from FSO, 25 years at 3 percent per annum, 4½ years grace. Total project cost is $221.5 million.

Purpose and Benefits: The projections of the regional models foresee a rise in the gross value of annual production from US$19 million before the program to US$41 million per year in the five regions of the sampling after the increases in the proposed production are consolidated. The projected annual family income indicates increases ranging from US$500 to US$1,000, that is, incomes could double or triple. The beneficiaries of small irrigation facilities could anticipate five-fold increases in their income levels. The economic indicators were consistent and favorable for the five regions of the sampling. The internal rate of return exceeded 14 percent in all cases and, in two, higher than 20 percent, based on the inclusion of investments in productive and production support activities as a cost. When the costs of the social investments were added, the internal rate of return dropped slightly but only in one case (Mexteca Alta) did it fail to reach 10 percent, due to the current low level of productivity. For the 15 regions of the program, the increased value of production attributable to the program could be as high as approximately US$35 million per year. This would come largely from traditional crops such as beans, corn and other cereals, supplemented by fruit and livestock production. The direct benefit, that is, the increase in net income attributable to the program after production is consolidated, was estimated at US$11.7 million per year for the five regions of the sampling. For the program as a whole (the 15 regions), net income of US$62.0 million could be attributed directly to the program's activities.

Date approved: October 30, 1975 (IDB)

AGRICULTURAL CREDIT: The program consists of the third stage of programs for farm credit to *ejidatarios* and small landowners which have previously received partial financial participation by the IDB through two global loans to Nacional Financiera, S.A. For those loans the executing agency was the Banco de Mexico, S.A., in its capacity as trustee for the Special Fund for Agricultural Financing (FEFA) trust, set up by the federal government under a contract signed on August 6, 1965; the Guarantee and Development Fund for Farming, Stock Raising and Poultry Raising (FONDO), and the Special Technical Assistance and Guarantee Fund for Agricultural Credits (FEGA). Those funds, together with other trust funds established in connection with agriculture, are handled by a department of the Banco de Mexico, S.A. known by its acronym FIRA. The principal executing agency would be FEFA, which operated as a second-tier mechanism rediscounting direct credit operations carried out by the 150 private and public financial institutions located throughout the country.

Borrower: Nacional Finaciera, Guarantor Republic of Mexico.

Loan: $30 million Ordinary Capital, 25 years at 8 percent per annum, U.S. equivalent $11 million FSO, 25 years at 3 percent per annum. Total project cost $97.4 million.

Purpose and Benefits: The Special Fund for Agricultural and Livestock Financing (FEFA) III Program would cover approximately 26,170 beneficiaries, preferably those belonging to one of the several forms of associations provided for in the country's agrarian legislation: small farm owners, mutually-responsible groups and local farm or ejidal credit societies. In determining the cost of the program the overall goals established were provision of subloans to 1,162 associative units with a total membership of approximately 26,170 beneficiaries distributed among various types of companies and in different geographic areas of the country. It is estimated that about US$36 million of the IDB-financed loans will go to beneficiaries belonging to associative units. The different types of associations provided for under the program are governed by the universal principles of the production cooperative. With the resources of the loans the IDB will finance fixed capital loans and the banks and other intermediary institutions participating in the program will contribute out of their own resources.

Date approved: November 11, 1975 (IDB)

AGRICULTURAL CREDIT: This program consists of the first stage of a plan for extending nationwide the agricultural credit and technical supervision which the Banco National de Credito Rural, S.A. (BANRURAL) carried out in the Lerma-Chapala-Santiago Basin irrigation area, the purpose being to provide such services in all irrigation districts with infrastructure financed partly through IDB loans. The major purpose is to promote and consolidate farm production in areas now served by irrigation facilities. It is estimated that 254 dairy units will be financed along with 8 beef cattle breeding units, 4 feeder cattle units, 12 sheep feeding units, 1 swine breeding unit and 13 swine feeding units. According to studies, livestock needs were estimated at 40,320 head of dairy cattle; 1,632 head of beef stock for breeding purposes and 4,000 head of beef feeder stock, 9,312 head of sheep, 1,050 hogs for the breeding unit and 12,480 feeder

MEXICO—Continued

hogs. Most of this dairy cattle would be imported. Furthermore, the program calls for the provision of needed machinery and equipment. To this end, a total of $2.9 million will be allocated in the credit budget for procurement of tractors, with associated equipment for earth working, and such equipment as may be needed for the stockraising operations such as milking sheds (milking equipment, automatic washing equipment, milk coolers, pumping equipment, etc.). Furthermore, the program budget calls for funds to be conveyed in the form of credit in the amount of about $3.7 million in order to pay for mechanized work needed by undertakings for which machinery will not be procured.

Borrower: Nacional Financiera, Guarantor Republic of Mexico.

Loan: $30 million Ordinary Capital, 25 years at 8 percent per annum. Total project cost is $80.7 million.

Purpose and Benefits: The program is intended to serve about 18,000 producers who, along with 109,000 family members, may be regarded as direct beneficiaries of the program. It is estimated that 80 percent of these producers would be members of *ejido* associations, cooperative or similar groups. According to studies done in the 12 irrigation areas, used to quantify the magnitude of the financial effort required and the scope of the program, the main items of production to be financed are food grains, oil seeds, fodder, fruit and livestock products. It is estimated that in the last year of program execution a total of 70,696 hectares of land will be under irrigation, meaning a 21.7 percent increase over the land area now under irrigation. The total area to be irrigated would be 59.7 percent sown to annual crops and 40.3 percent to perennial crops.

Date approved: November 20, 1975 (IDB)

WATER SUPPLY: The project calls for the following: (a) *Water supply.* (i) Construction of deep wells to yield an estimated flow of 1,200 liters per second. (ii) Equipping and interconnection of wells to expand flows approximately 2,700 liters per second. (iii) Construction of storage tanks with a total estimated capacity of about 210,000 cubic meters. (iv) Construction of approximately 37,000 meters of distribution lines with diameters of 0.60 meter or more. (b) *Sewerage.* Construction of approximately 27,000 meters of subcollectors, collectors and emissaries with diameters of 0.60 meter or more. The proposed water supply works are projected to serve 110,000 more connections than are now in existence, so as to provide new service to some 575,000 persons. The proposed sewerage works will enlarge the area of collection of sewerage and place the points of discharge farther away from the central city.

Borrower: Banco Nacional de Obias y Servicios Publicas S.A.; Guarantor, United States of Mexico.

Loan: $17 million from Ordinary Capital resources, 20 years at 8 percent per annum. Total project cost is $45 million.

Purpose and Benefits: Monterrey Water Supply Commission estimates a general rate of population growth of 5.4 percent per annum to 1985 and 5.0 percent thereafter. According to these projections, the Monterrey metropolitan area, which had 1,556,000 inhabitants in 1975, will probably increase to some 2,100,000 by 1981. The planning for expansion of urban services in the Monterrey sub-region of Nuevo Leon State was set forth in a master plan published in 1967 which is now being brought up to date by the State Planning and Works Commission. In regard to water supply and sewerage, Monterrey has been characterized by a noteworthy degree of continuity and consistency in pursuing long range objectives through the accomplishment of successive expansion projects designed to cover the needs of the community for periods of approximately five years each.

Date approved: April 29, 1976 (IDB)

TOURISM: The project is a continuation of the comprehensive development of tourism infrastructure on the island of Cancun and its area of influence along the coast of Quintana Roo State. The purpose of the project is to consolidate infrastructure and tourism and urban facilities including: (a) *In the tourism zone:* Widening of the Nichupté bridge and the access roads to beaches and hotels; dredging, landfills, breakwaters, and jetties; water supply, sewerage, energy generation and transmission and electric lighting; arrangement and conditioning of a park, a residential area; boulevards, public beaches, berths; a marina, and restoration of archeological sites. (b) *In the urban zone:* Water supply, sewerage, electrification, grading and paving for urbanization of seven *manzanas* of land to be used for housing and shops for the local population, reconditioning of streets, avenues, a park and plazas, construction of a secondary school and enlargement of a tourism training school; improvement of the sports field and two zonal markets for supply of essential goods.

Borrower: United States of Mexico.

Terms: $20.0 million from Ordinary Capital resources, 18 years at 8 percent per annum. Total project cost $49.5 million equivalent.

Purpose and Benefits: Cancun Stage I exercised a "magnetic attraction" throughout the country. The area's population has risen from 171 to the present 10,000 inhabitants. While it was expected that most of the migrants would come from Yucatan peninsula, little knowledge was available about the possible reactions of these Mayan descendents to types of work different from their traditional occupations. Accordingly, even as work progressed on the tourism infrastructure, a continuing social welfare program was organized to guide incoming workers and their families, to train personnel and to help convert new arrivals into permanent settlers. The multiplier effect associated with projects of this type is evident. The availability of the initial infrastructure facilities generated an inflow of national tourists in such volume that it was necessary to repair a secondary landing field for temporary use. The vast majority of families that moved to Cancun are receiving much higher wages than previously. The average monthly wage being received by workers in September 1975 was US$71 above their previous wage. This increase is not, of course, an exact measure of the rise in the worker's standard of living. On the one hand, it does not take account of the rise in the cost of living in Cancun, while, on the other hand, it overlooks such services as water, electricity, health and education which the people are receiving for the first time or at a relatively lower price.

Date approved: May 6, 1976 (IDB)

AGRICULTURE: This program will develop a new dairy shed in the municipality of Tizayuca, State of Hidalgo. The beneficiaries of the credits are to be individual dairy operators relocated to the new dairy shed, of whom at least 70 percent would come from the Federal

District and up to the remaining 30 percent could be other individuals with experience in the management of dairy cattle.

Borrower: Nacional Financiera, Guarantor: United States of Mexico.

Loan: $44.8 million from Ordinary Capital, 18 years at 8 percent per annum, 4½ years grace period. Total cost is $89.6 million.

Purpose and Benefits: The government's decision to shut down the cow barns in the urban area of Mexico City is expected to produce considerable health benefits deriving from environmental improvement in the urban areas concerned, together with other benefits for human health, including less sickness-related absenteeism from work, lower medical care costs and lower mortality rates as a consequence of removing infected animals and improving the quality of the milk available to users. It can therefore be considered that the government program will show a substantial excess of economic benefits over the projected costs.

Date approved: May 6, 1976 (IDB)

NICARAGUA

POWER: The purpose of this project (the first stage of the Second National Rural Electrification Plan) is to supply electric energy to 21,600 new consumers. The Plan covers a 10 year period and an area of 4,600 km with some 70,000 inhabitants. This loan provides for the expansion of two existing substations; construction of 94 km of 138-KV single-traid transmission lines, with aluminum-steel (ACSR) conductors mounted on metal towers; installation of two substations with 138/69 KV-7,500 KVA and 138/24.9/14.4 KV-5,000 KVS transformers; construction of 163 km of 69 KV single-traid transmission lines, with ACSR conductors mounted rigid-frame wooden structures; installation of four substations with 69/24.9/14.4 KV primary distribution lines in monophase, triphase and tetraphase circuits; installation of 1,162 MT/BT transformers with the necessary house connections and service meters; and installation of 525 km of secondary distribution lines.

Borrower: Republic of Nicaragua, Empresa Nacional de Luz y Fuerza (ENALUF).

Loan: $16.5 million, 40 years at 2 percent. Total project cost is $20.9 million.

Purpose and Benefits: Approximately 900,000 of Nicaragua's inhabitants are classified as rural population and only 20 percent of these are currently provided with electrical service. The first area to be assisted by this project (the Department of Matagalpa) is the largest dairy zone in Nicaragua. In addition to dairy farming, cattle raising and fattening, hog and poultry raising, coffee and food crops are also major farm activities. The gross value of this area's agricultural output was estimated to be the equivalent of US$12.7 million for 1974. The second area to be serviced by the project (the Department of Zalaya) is also an agricultural area with grain production, cattle raising and fattening, and lumbering. Agricultural production for 1974 is estimated to have been the equivalent of $6 million. The project component for Matagalpa area has an estimated 11 percent internal rate of return; the project in the Department of Zalaya has an estimated 9.8 percent internal rate of return.

Date approved: September 11, 1975 (IDB)

PANAMA

TRANSPORTATION: This program consists of building eight rural roads (approximately 214 km) in rural areas currently lacking road facilities and inhabited by low-income groups.

Borrower: The Republic of Panama, The Ministry of Public Works (MOP)—the Dirreccion Nacional de Construccion (DNC).

Loan: $30.0 million, 30 years at 2 percent. Total project cost is $43.9 million.

Purpose and Benefits: The objective of this project is to build and improve rural roads in order to incorporate new production areas into the national economy and improve substantially the socio-economic conditions of the rural inhabitants. The internal rates of return on these investments is estimated to range from 13 percent to 22 percent.

Date approved: September 11, 1975 (IDB)

VOCATIONAL EDUCATION: The program to be supported with this loan includes: (a) introduction of education reform by means of Basic Cycle Schools and Vocational and Technical Institutes with the object of improving the quality of the instruction and making it possible to provide students with training at various levels; (b) advanced training of instructors and directing and supervisory staff of the Basic Cycle Schools and Vocational and Technical Institutes, through sending 41 instructors abroad for intensive and specific courses; (c) construction of 23 new schools, including 19 Basic Cycle Schools and 4 Vocational and Technical Institutes, with related urban improvements; and (d) equipping of these schools with machines, tools, teaching materials, furnishings, laboratory equipment and textbooks. The Bank is providing support for the first two of these activities through nonreimbursable technical cooperation; action in the other two fields will be financed in part with this loan.

Borrower: Republic of Panama.

Loan: $12.2 million from FSO, 30 years at 2 percent per annum, $338,000 included as nonreimbursable technical cooperation. Total project cost is $18.0 million.

Purpose and Benefits: Outlays for education have accounted for approximately 25 percent of Panama's total current public expenditures since the 1950's. Nevertheless, because of dynamic economic expansion during the period 1960–1972 (growth at 8 percent per year) the country is faced with a shortage of skilled manpower—particularly acute in the case of middle-level technical personnel—which the educational system has not been able to produce in the numbers and at the times needed. Part of this is due perhaps to concentration on general, as contrasted with specialized, education.

The program is an integral part of a reform which has as its principal objectives to reorient, expand and improve the whole education system, placing special emphasis on the acquisition of practical and technological knowledge to accord with the economy's needs. Structural change in the existing intermediate schools has required concurrent modifications in various other respects: modernization of the structure of the education system; and improvement and provision of furnishings, equipment and teaching materials. The new nine-year program known as General Basic Education replaces the six years of primary studies and three years of intermediate studies under the present system. The last three years of the General Basic Education program will be called the Basic Cycle.

Date approved: December 4, 1975 (IDB)

PARAGUAY

AGRICULTURE: This animal health program has several objectives: (a) improvement, expansion and construction of facilities at the isolation station and inoculation camp, and construction of 16 fixed transit-control stations, as well as the access road to the official laboratory; (b) purchase of technical inputs needed for the campaign, and (c) procurement of the following equipment: (i) transportation equipment to enable executing agency's staff to cover 100 percent of the national territory; (ii) laboratory equipment; (iii) maintenance equipment and spare parts; (iv) field equipment; (v) refrigeration equipment; (vi) health education and information equipment; (vii) sanitary surveillance equipment, and (viii) office equipment.

Borrower: Republic of Paraguay.

Terms: $3.2 million from the Fund for Special Operations, 40 years at 1 percent per annum the first 10 years, 2 percent thereafter. $310,000 technical cooperation.

Purpose and Benefits: Paraguay has the seventh largest livestock population in Latin America and livestock and animal products have accounted for 9 percent to 10 percent of the country's gross domestic product (GDP) in recent years. Cattle production and exports are, however, subject to wide fluctuations, particularly because of constraints on genetic improvement, which have kept the rate of natural growth in the country's herds to only 1 percent during the period 1968–74. The aim of the Campaign against foot-and-mouth disease is to increase this growth rate by 60 percent, to 1.6 percent per year.

Date approved: December 18, 1975 (IDB)

PERU

HIGHWAYS: This project provides for: (1) reconstruction of the existing highway (approximately 190 kilometers) between Olmos and Corral Quemado, and its conversion to an asphalt-paved highway of category II design; and (2) acquisition of traffic count, laboratory and communications equipment and of vehicles for the transportation of supervisory staff.

Borrower: Republic of Peru.

Loan: $37.6 million from FSO, 25 years at 2 percent per annum. Total cost is $72.4 million.

Purpose and Benefits: The Peruvian Government has decided to use highway projects as one of the basic supports of its regional development policy, which is directed, *inter alia,* to bringing about a more rational use of land by accelerating the growth of employment opportunities and providing necessary basic services in rural areas. This policy also helps to solve food supply problems for existing major population centers. The zone of influence of the project includes land with a rich agricultural potential but which is currently lagging behind the country as a whole in terms of economic and social development. Within this zone of influence are regions classified by the national authorities as "depressed areas" and "economic frontier" regions identified in national plans at potential regional development poles.

Date approved: January 15, 1976 (IDB)

POWER: This project includes: (i) expansion of the Machu Picchu Hydroelectric Power Plant from 40 MW to 110 MW; (ii) construction of a second 138 KV line to the lead center, with corresponding substations; (iii) subtransmission lines to the Valle Sagrado de los Incas; (iv) the underground distribution network for the city of Cuzco; (v) construction of a central electro-mechanical workshop in the vicinity of this city; and (vi) acquisition of telecommunications and railway equipment.

Borrower: Electricidad del Peru, Guarantor Republic of Peru.

Loan: $25.84 million and Bs27,778 million from the Venezuelan Trust Fund, 20 years at 8 percent per annum. Total project cost is $64.6 million.

Purpose and Benefits: At the end of 1974, Peru's installed generating capacity was 2.3 million KW (1.4 million KW in hydroelectric plants and 0.9 million KW in thermo-plants) and annual generation was at 7.3 million KWH. For an estimated population of 14.3 million, this was equal to 160 watts of generating capacity and 510 KWH of annual generation per capita, placing Peru in an intermediate position among the Latin American countries. While total electric energy production has been increasing at a rate of 6 percent per year during the last 10 years in the country as a whole, urban service has shown an increase well above 9 percent, reflecting dynamic development in the country's urban areas. The basic aim of Peruvian Government electric power policy is the establishment of larger electric power systems subject to management by a single state enterprise (ELECTROPERU), in order to provide for rational utilization of energy resources in terms of national economic development requirements. The hydroelectric project of Machu Picchu is part of the government's overall electric power plan.

Date approved: January 22, 1976 (IDB)

REGIONAL

TRANSPORATION: This project will support continuation of the highway construction and improvement work undertaken by the Central American Bank for Economic Integration (CABEI). It represents a new effort to accommodate the Central American highway system to the growing needs of the regional integration process. The program consists of several highway projects (about 260 kilometers) characterized as priority integration highways. The projects which the Bank will assist in carrying out with this loan are parts of the Central American highway system identified in the Central American Transport Survey (1964/1965). The projects will be carried out by means of long-term subloans to be made by CABEI to the Central American Republics and/or to government institutions of the countries of the region, in conformity with the standards and procedures of the Central American Fund for Economic Integration (CAFEI).

Borrower: Central American Bank for Economic Integration (CABEI).

Loan: $25 million, 30 years at 1 percent per annum during the first 8 years and 2 percent per annum thereafter. Total cost is $31.3 million.

Purpose and Benefits: The objective of the program is to enhance Central American economic development and integration efforts through the construction and/or improvement of highways to facilitate the expansion of production as well as trade in goods and services among the countries of the region.

Date approved: July 3, 1975 (IDB)

WATER SUPPLY: This loan will help finance the preparation of studies for an agricultural development project based on irrigation in the binational Puyango-

Tumbes watershed. The following activities will be undertaken: (a) a technical and economic study to select the best possible alternative for building the basic irrigation works; (b) a technical, economic and financial feasibility study on the alternative chosen; (c) necessary geotechnical investigations for final designs; (d) final designs on the dam (or dams) and/or tunnels; (e) preparation of the investment project with the documentation necessary for supporting a loan application to be submitted to an international lending agency. The project is to be carried out in two stages, the first of which includes two phases: (a) a phase of basic studies and analysis of alternatives and (b) a phase for a feasibility study of the alternative chosen and geotechnical investigations. The second stage comprises the preparation of the final designs.

Borrower: Comision Mixta Peruano-Ecuatoriana; Guarantors: The Republics of Peru and Ecuador.

Loan: \$5.2 million from FSO, 30 years at 2 percent per annum. Total project cost is \$9.1 million.

Purpose and Benefits: The binational Puyango-Tumbes watershed encompasses areas in Ecuador and Peru amounting to a total of 5,500 square kilometers (3,700 in Ecuador and 1,800 in Peru). Administratively, the irrigation area of the project is in the El Oro Province of Ecuador (50,000 hectares) and the Tumbes Department in Peru (20,000 hectares). Much of this area is now considered to be desert, located at the coastal slope, with elevations ranging from 5 to 120 meters above sea level. The development project will provide direct benefits to some 7,000 families (2,000 in Peru and 5,000 in Ecuador) in some of the most economically depressed areas in those countries.

Date approved: December 18, 1975 (IDB)

ASIAN DEVELOPMENT BANK

AFGHANISTAN

AGRICULTURE: The loan funds will help to finance the foreign exchange component of (i) the cost overrun of the original irrigation project, and (ii) construction of Power Station III including a standby diesel generator.

Borrower: Afghanistan, Water and Power Authority (WAPA).

Loan: $10.8 million, (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum.

Purpose and Benefits: Although project costs have increased considerably since the project was first appraised in 1970, the project remains economically viable and will bring considerable economic and social benefits to the country. Upon completion of the project, expected in mid-1980, the increased production of wheat, sugar beets and cotton will result in an annual foreign exchange savings/earnings of $9 million through import substitution and increased exports. It is estimated that about 75,000 people living in the project area will directly or indirectly benefit from the project, particularly by substantially increasing the incomes of farmers. The construction of Power Station III, besides providing the source of electricity required for the operation of the Larkhawi pumping station, will supply surplus power to the area. The project remains viable with economic internal rates of return estimates at 10.6 percent for the Gawargan sub-project, including the Larkhawi extension area and Power Station III, and 15.6 percent for the Chardarrah sub-project, compared with the original estimates of 16.2 percent and 15.1 percent, respectively.

Date approved: June 29, 1976 (ADB)

BANGLADESH

AGRICULTURE: The credit will help finance an agricultural credit project to help farmers finance: (a) 5,500 shallow tubewells, accessories, spare parts, related civil works and field services; (b) about 50 power tillers, with accessories and spare parts; (c) facilities for the operation and maintenance of the tubewells and the tillers; (d) required initial technical inputs such as fertilizers, seeds and insecticides; and (e) provision of selected office equipment, accessories and vehicles for the executing agency, the Bangladesh Krishi Bank (BKB).

Borrower: People's Republic of Bangladesh.

Loan: $9.43 million (Special Funds); 40 years (including a 10-year grace period) with a 1 percent service charge per annum. Total project cost: $13.5 million equivalent.

Purpose and Benefits: Bangladesh is one of the least developed member countries of the Bank, having a very low per capita income and a critical balance-of-payments situation. The project conforms to national objectives of self-sufficiency in food grains, and it will generate 11,000 full time and 23,000 part time jobs. In addition to bringing 33,500 acres of land under assured irrigation, the project will improve income and living standards of nearly 14,000 farm families. Moreover, it will strengthen the organization and operations of BKB, the main rural credit institution in the country. The project is technically feasible, financially viable and economically sound, having a high financial rate of return of 47 percent and an economic rate of return of over 50 percent.

Date approved: November 25, 1975 (ADB)

GAS PIPELINE: The loan will help finance a project to expand gas distribution facilities in the Greater Dacca area.

The project comprises: (a) installation of (i) about 48.3 km of primary distribution lines, (ii) about 643.7 km of secondary distribution lines, (iii) regulating and metering stations, and (iv) conversion equipment for industrial units and burners for domestic/commercial customers; (b) provision of foreign experts and quantities of drilling mud, tubing and spare parts for repairing a production well; and (c) technical assistance for the overall organizational and personnel development programs of the Titas Gas Transmission and Distribution Company Ltd.

Borrower: People's Republic of Bangladesh.

Loan: $12.2 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Total project cost: $26.9 million equivalent.

Purpose and Benefits: The objective of the project is to maximize natural gas utilization in order to reduce substantially the amount of foreign exchange presently expended on kerosene and furnace oil. Foreign exchange savings, estimated on the basis of 1974–75 import prices, are expected to average $14 million annually. The project also will make cheaper fuel available to 37,550 new domestic, commercial and industrial customers. The Government has given high priority to the project: The project is technically feasible, financially viable and economically sound, having a financial rate of return of 12 percent. The economic rate of return, calculated on the basis of net import savings effected by the investment proposed under the project, is 50 percent. The technical assistance should do much to strengthen managerial efficiency of TGTDC, the executing agency.

Date approved: December 23, 1975 (ADB)

BURMA

MANUFACTURING: The loan proceeds will finance the foreign exchange cost of a project to establish a jute mill with an annual output capacity of 14,500 tons. The project consists of: (a) site preparation; (b) civil works; (c) building construction; (d) procurement and installation of machinery and equipment; (e) construction of off-site facilities to include a berthing jetty, access roads and staff residences; and (f) consultant services.

Borrower: Socialist Republic of the Union of Burma.

Loan: $25.3 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Total project cost: $43.3 million equivalent.

Purpose and Benefits: During 1973 and 1974, the country's only existing jute mill (Okkyin) processed 20,000 tons into jute goods for domestic consumption, with the balance of raw jute production being exported and earn-

BURMA—Continued

ing $11 million in foreign exchange. Domestic demand for jute products is suppressed. The shortage of jute bags has stimulated smuggling and blackmarket sales of bags with consequent losses of revenue to the Government, and the use of old bags has contributed to losses in the bagging of rice and other food crops totaling several hundred thousand tons per year. Domestic demand is estimated to be 22,000 tons higher than Okkyin's capacity. Importing to meet the demand would generate a foreign exchange drain of $14 million annually. On the basis of incremental production, the project is expected to average $10 million in foreign exchange savings per year, and about $150 million over the 15 year life of the project. It also is expected to create 2,000 new jobs. The financial rate of return on the project is estimated to be 14.9 percent. The economic rate of return is estimated at 16.7 percent.

Date approved: November 25, 1975 (ADB)

POWER: The credit will supplement a previous Bank loan from Ordinary Capital resources for $2.1 million, and a previous credit from Special Funds resources for $4.0 million for the same project, both authorized December 6, 1973. The supplement will finance a foreign exchange cost overrun.

Borrower: Socialist Republic of the Union of Burma.

Loan: $6.1 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Change in total project cost: From $9.1 million equivalent to $19.5 million equivalent.

Purpose and Benefits: The cost overrun was caused by sharp price escalation in major project components, such as structural steel, aluminum conductors and manufactured electrical equipment, escalations attributable to the energy crisis. The project is designed to transmit power generated by two gas turbine powered stations on the west bank of the Irrawaddy River to several load centers. It includes 40.2 km of double circuit transmission line from the Kyunchaung gas turbine power station to the Chauk substation on the east bank; 329.9 km of double circuit transmission line from the Myanaung gas turbine power station to Sinde and Myaungmya; and construction of four substations, including transformers and related equipment. Industrialization is progressing along the Irrawaddy River and the project will assist further industrial development in the area. The project will satisfy considerable suppressed demand and is important to Burma's economic and social development. Both power stations have already been completed and adequate transmission facilities are essential to operations. The revised project is technically and economically viable. Moreover, the project will result in substantial foreign exchange savings because the gas turbine equipment will use coal for fuel, which is available locally. The financial rate of return is estimated to be 9.4 percent. The economic rate of return, based on the incremental costs and benefits, is estimated to be 10.4 percent.

Date approved: November 27, 1975 (ADB)

AGRICULTURE: The project proposed for Bank financing consists of the following components: (i) Establishment of a storage dam, constructed as an earth dam, related structures, penstocks and foundation for a power house. The dam will have a total length of 1,424 m and a maximum height above the river bed of 39 m. (ii) Irrigation and drainage works and construction of road systems for the rehabilitation of the Mandalay Irrigation Scheme, the completion of the Yenatha Irrigation Scheme and the construction of the Pump Irrigation Scheme. (iii) Implementation of an integrated agricultural and fisheries development program, including agricultural research, extension services, credit, supply of inputs, etc. (iv) Construction of a 33 kV transmission line from Madaya to the dam site to provide power during construction and to the pumping stations of the Pump Irrigation Scheme upon completion. (v) Enlargement of a lateral irrigation canal connecting the Mandalay main canal with the moat in Mandalay to a capacity of 4.9 cu.m./sec. to augment the water supply for the city.

Borrower: Burma, The Ministry of Agriculture and Forests (MAF).

Loan: $45.9 million, (Special Funds); 40 years at one percent per annum; Total cost $78.1 million.

Purpose and Benefits: The main objective of the project, which is the major part of the Sedawgyi Multi-Purpose Development Scheme, is to increase agricultural output, mainly paddy, cotton and groundnuts, in the areas under the Mandalay Irrigation Scheme, the Yenatha Irrigation Scheme and the so-called Pump Irrigation Scheme in the dry zone of Central Burma, and thereby to increase the homes of the farming communities presently in the areas and to provide opportunity for settlement of additional farmers. The objective would be achieved primarily by provision of sufficient irrigation water to grow two crops per annum. The project area of 51,400 ha presently has a cropping intensity of 113 percent, but after provision of an assured year-round irrigation water supply, cultivation will be considerably intensified and it is expected that the cropping intensity will reach 195 percent at full development. Due to shortage of irrigation water, only 14,900 ha of the total 51,400 ha are presently double cropped under the Mandalay Irrigation Scheme. The areas under the Yenatha and Pump Irrigation Schemes are still dependent on rainfall. After completion of the project, paddy, cotton and groundnuts will comprise 84 percent of the cropped area; the remaining 16 percent will be for pulses, chillies, vegetables, fodders and orchards. Paddy will continue to be the dominant crop and high yielding varieties will gradually replace traditional varieties. Total annual paddy production is estimated to increase almost four times, from about 63,000 m.t. at present to 246,000 m.t. at full development, with the average yield reaching about 4.3 m.t./ha. Annual cotton production will more than triple, from 5,100 m.t. to 16,000 m.t., and annual groundnut production will increase from 720 m.t. to 11,100 m.t. The economic rate of return is estimated to be 21 percent.

Date approved: June 22, 1976 (ADB)

HONG KONG

SEWERAGE: The loan will help finance part of the foreign exchange costs of a sewerage treatment project in Sha Tin, one of Hong Kong's new satellite towns. The project will comprise: (a) construction of a main pumping station; (b) laying 2 km of twin pipelines; and (c) construction of sewage treatment facilities.

Borrower: Crown Colony of Hong Kong.

Loan: $20.0 million (Ordinary Capital); 15 years (including a 5-year grace period) at 9½ percent interest per annum. Total project cost: $61.5 million equivalent.

Purpose and Benefits: The project is essential to the development of Sha Tin and will provide sewage treatment facilities for a population of 226,000. The development of new towns such as Sha Tin has a strong social and economic justification in view of conditions in Hong Kong urban areas. Presently, about 86 percent of the

Colony's population of 4 million live in approximately 49 square km of urban area, which has had to overcrowding and overloading of infrastructure facilities. As a result, community services have become increasingly inadequate, difficult to maintain and expensive to improve, and consequent pollution problems are rapidly approaching the critical stage. The Government's response to these problems is to develop new settlements such as Sha Tin to resettle some of the population. These new towns are designed to be completely self-contained with modern structures, good communications with Hong Kong's main business districts, new employment opportunities, and each will have all of the communal facilities suitable for a population of about a half-million. Sha Tin is on the shore of Tide Cove, which feeds into Tolo Harbor, and both are showing signs of accumulated pollution from the existing level of discharges into their waters. This pollution will diminish with the implementation of the project, since the sewerage facilities will control the quality of discharges from Sha Tin and from neighboring areas. Cost comparisons between the available alternatives established the project as the least-cost solution to the sewage treatment problem in Sha Tin. In the absence of the project, Sha Tin would have less attraction as a resettlement location and the already overcrowded areas of the Colony would become even more crowded. Failure of the new towns scheme would result in substantial increments in the costs of providing and maintaining general infrastructure and housing, and any additions to these existing facilities—wherever space would permit—would be at extremely high cost. In particular, improvements that have been recommended by the consultants to the Colony's existing sewerage system would be required at an early date and perhaps on a scale much larger than originally envisaged.

Date approved: October 9, 1975 (ADB)

INDONESIA

MANUFACTURING: The loan will finance the foreign exchange cost of the Gohor Lama Palm Oil Processing Project, located in North Sumatra, about 65 km northwest of Medan, the provincial capital. The project involves: (a) construction of a palm oil processing mill at Gohor Lama with a capacity for 30 tons of fresh fruit bunches per hour and will include (i) workshops, (ii) warehouses, (iii) oil storage tanks, (iv) clarification ponds, (v) housing and (vi) offices; (b) the construction and rehabilitation of railways and roads; (c) provision of transport equipment for fresh fruit bunches, kernels and oil; (d) construction of bulk storage facilities at Belawan; and (e) consultant services to assist with the overall supervision of mill erection and staff training.

Borrower: Republic of Indonesia.

Loan: $11.3 million (Ordinary Capital); 20 years (including a 4-year grace period) at 8¾ percent interest per annum. Total project cost: $15.6 million equivalent.

Purpose and Benefits: The loan project would promote production of an exportable commodity—palm oil—for which long-term demand in world markets is expected to increase. Although the output of palm kernel oil is expected to be consumed locally as a substitute for coconut oil, net foreign exchange earnings from palm oil exports are estimated to average $6.1 million per annum during the project period. The project also would increase Government revenues by about $2.5 million per annum after full development. About 1,500 families are expected to benefit from an associated settlement scheme. The financial and economic internal rates of return are estimated at 13.9 percent and 20 percent respectively. Sensitivity tests have shown that the project would continue to be economically viable even under adverse conditions, such as a 20 percent decrease in palm oil prices or a 20 percent increase in production costs.

Date approved: November 6, 1975 (ADB)

TECHNICAL ASSISTANCE: The loan will finance part of the foreign exchange cost of technical assistance necessary for a feasibility study to determine the scope and configuration of the proposed Karangsambung Multi-Purpose Project. As visualized by the Government, the major project components would be: (a) multi-purpose dam and reservoir; (b) power plant, sub-station and transmission lines; (c) after-bay and diversion weir; (d) irrigation and drainage facilities (both new and rehabilitated) to complement and assure full benefit from the abovementioned irrigation and drainage facilities; and (e) other infrastructure facilities necessary to support the project.

Borrower: Republic of Indonesia.

Loan: $2.9 million (Ordinary Capital); 10 years (including a 2-year grace period) at 8¾ percent interest per annum. Total project cost (feasibility study): $5.4 million equivalent.

Purpose and Benefits: Construction of the Karangsambung Multi-Purpose Project is essential to the goal of increasing food production in South Central Java. Moreover, development of an inland fishery in the reservoir area would increase the protein available for consumption in the South Kedu Region of Central Java. If found feasible, the power plant will help relieve suppressed demand for power on the Central Java grid. The project will have significant social and income effects on the Purworejo and Kebumen Region through the creation of indirect employment, provision of domestic and urban water supplies, and expansion of markets for foodcrop production and procurement of production inputs. No adverse environmental effects are expected to arise upon completion of the Multi-Purpose Project.

Date approved: November 6, 1975 (ADB)

POWER: The loan funds will finance the foreign exchange cost of the Garung Hydroelectric Project, which consists of: (a) construction of a new hydroelectric power station with two generation sets; (b) related works, including (i) a dam, (ii) intake structure, (iii) penstock, (iv) power house, and (v) switchyard; (c) construction of 70 km of transmission line connecting Garung and Magelang; and (d) engineering services.

Borrower: Republic of Indonesia.

Loan: $19.8 million (Ordinary Capital); 25 years (including a 4-year grace period) at 8¾ percent interest per annum. Total project cost: $31.9 million equivalent.

Purpose and Benefits: The project is an essential part of the plan of the Government-owned electric utility, the Perusahaan Umum Listrik Negara (PLN), for the development of power in Central Java. It will increase the availability and improve the reliability of power supplied to Wonosobo, Garung, and Magelang by an interconnecting transmission line which is scheduled to link major electricity consumption centers in Central Java. The project is expected to promote industrial and economic development in the region by responding to the overwhelming demand for electricity which PLN heretofore has been unable to supply. Moreover, the project is ready for early

INDONESIA—Continued

implementation, which will cause its benefits to accrue much sooner than is customary for such projects, and, as a hydropower project, if offers the additional advantage of conserving resources. The internal financial rate of return is estimated at 10.9 percent. In view of the negligible transfer payments, the internal economic rate of return is estimated to be substantially the same as the financial rate of return. However, the overall economic benefits will be much larger, by virtue of a number of advantages that are not quantifiable. These include improvement in the reliability and efficiency of the power supply, partial realization of interconnection to the main transmission system, elimination of comparatively high cost new private generating units, and all of the broad development progress these will foster.

Date approved: November 13, 1975 (ADB)

AGRICULTURE: The loan will help finance Phase I of the Telok Lada Area Development Project, which consists of: (a) constructing two irrigation weirs in West Java and associated distribution canals and drains, and access roads; (b) intensified rice demonstration pilot schemes, including supporting services for farm input delivery and farmer associations; (c) soil conservation and reforestation in the catchment area; (d) installation of hand pumps for village water supplies; and (e) consultant services.

Borrower: Republic of Indonesia,

Loan: $12.2 million (Ordinary Capital); 27 years (including a 7-year grace period) at 8¾ percent interest per annum. Total project cost: $21.6 million equivalent.

Purpose and Benefits: Agriculture continues to be the mainstay of Indonesian economy, accounting for 40 percent of GDP, 60 percent of employment, and virtually all nonpetroleum exports. The Government's objectives are to increase agricultural exports, raise the productivity of farmers, and reduce rural unemployment. The Teluk Lada Plain is one area identified for development, and totals 25,400 hectares. The area is depressed, and the bulk of its population is engaged in low-yielding, rain-fed rice cultivation. The area lacks infrastructure and is subject to flooding and water logging. The main beneficiaries of the project will be area farmers, totalling 9,400 households, who live mostly at the subsistence level on per capita annual incomes of about $32. The project is expected to increase farmer income fourfold, even after payment of land taxes and water use charges. It also is expected to help reverse the increasing disparity between urban and rural incomes which has been exacerbated by the skewed distribution of oil revenues and urban development. The project also will contribute to the Government's feedgrain self-sufficiency goal through incremental production of 23,300 tons of milled rice per year. Substantial employment benefits will derive from the project: During construction, 2.6 million man-days will be required, and afterward, an additional 4,000 man-years will be needed for intensive irrigated farming. The economic rate of return is estimated to be 14.6 percent.

Date approved: November 27, 1975 (ADB)

EDUCATION: The loan will help finance a project to improve the quality of instruction received by university students of civil, mechanical, electrical and chemical engineering in order to increase the number and quality of Indonesia's graduates in these fields. The major components of the project are: (a) construction of a new integrated campus that includes student and faculty housing, classrooms, laboratories and workshops at a site already acquired near Surabaya; (b) provision of equipment for laboratories and workshops; (c) provision of teaching aids, including library equipment, reference books and textbooks, and journals; (d) establishment of an academic link between the Surabaya Institute of Technology (ITS) and a recognized foreign university in order to facilitate modernization of the ITS curricula and upgrade its academic standards; and (e) implementation of a staff development program through postgraduate work at foreign universities.

Borrower: Republic of Indonesia.

Loan: $14.5 million (Ordinary Capital); 30 years (including a 6-year grace period) at 8¾ percent interest per annum. Total project cost: $25.2 million equivalent.

Purpose and Benefits: The Government has given high priority to the improvement of technical education to support its development strategy, and the project conforms to the Government policy for the development and improvement of engineering education. Present production of engineering graduates in Indonesia is inadequate to meet the growing manpower needs for implementation of the Government's development program. These needs currently are being met partially by employing expatriate engineers. The target of the project is to graduate 250 well-trained engineers annually, the equivalent of one-quarter of the country's annual requirements. The project, besides helping Indonesia to meet its engineering manpower requirements, also will help the country to redress regional imbalances in educational facilities and opportunities. Located in East Java, the project's benefits should spill over onto that region. The project is well planned to meet the immediate and long-term objectives of ITS. With improved facilities, a better prepared staff, more completely equipped laboratories and workshops, the present high drop-out rate should abate since the students will have more incentive to complete the five-year program, given their expectation that it will prepare them adequately for careers as engineers.

Date approved: December 2, 1975 (ADB)

TECHNICAL ASSISTANCE: The loan will help finance the foreign exchange costs of a project to procure consultant engineering services for the first stage expansion of the ports of Belawan and Surabaya, and for comprehensive hydraulic studies for Belawan port. The main project components are: (a) detailed engineering investigations, design, and preparation of tender documents for facilities to be constructed under the first stage expansion of these two ports; (b) hydraulic studies for the Belawan port, including training abroad for Government officials in the field of hydraulic model testing and analysis; and (c) provision of 60 man-months of technical expert services to the port administrations of Surabaya and Belawan and to the central Directorate General of Sea Communications (DGSC) for implementation of the project.

Borrower: Republic of Indonesia.

Loan: $4.4 million (Ordinary Capital); 10 years (including a 2-year grace period) at 8¾ percent interest per annum. Total project cost: $6.5 million equivalent.

Purpose and Benefits: Surabaya in northeast Java is the second major port of Indonesia and its facilities are being improved under an on-going, Bank-financed project which will increase its general cargo handling capacity to about 3.3 million tons by 1977. However, the port's general cargo traffic is projected to reach that tonnage level by 1978. Taking into account the expected future increase, it would be necessary to expand port facilities further by constructing eight new inter-island berths by 1980. Belawan in northeast Sumatra is the third major port of Indonesia and its present general cargo handling capacity is about 1.7 million tons as compared with an anticipated traffic of 2 million tons in 1975, and which is projected to increase to 5.5 million tons by 1983. Expansion of the port is, therefore, considered urgent and would involve construction of five additional berths for ocean-going vessels. In view of Indonesia's geography of 3,000 islands spread over a large area, a functioning ports system, fully capable of handling the inter-island traffic as well as external trade, is of paramount importance to the country's economy as a whole. The ports included under the project thus perform a vital role, and between them, handle the major portion of the Indonesia shipping traffic. The internal economic rates of return for the resultant port projects are estimated at 22 percent for Surabaya and 25 percent for Belawan. The anticipated investment for Belawan during 1978–81 will be about $93 million (the foreign currency component being $50 million) and for Surabaya during 1978-81 about $42 million ($24 million as foreign currency). When the proposed technical assistance project is completed, the Government intends to seek financing from the Bank for the construction of the Phase I development of both ports.

Date approved: December 2, 1975 (ADB)

POWER: The Maininjau Hydropower Project consists of: (i) construction of a new hydroelectric power station with four 17 MW generation sets and related works; (ii) construction of a transmission system for delivering power to the main load centers including 105 km of 150 kV and 25 km of 20 kV transmission line; and (iii) consultant services for project implementation.

Borrower: Republic of Indonesia, National Public Electricity Corporation (PLN).

Loan: $39.7 million (Ordinary Capital); 25 years including a grace period of 5 years, at 8¾ percent per annum. Total project cost: $62.7 million.

Purpose and Benefits: The Project constitutes an essential part of PLN's generation development plan in West Sumatra. It will provide low-cost power for major development projects, reduce losses due to generation interruptions on existing self-contained systems, and replace small and uneconomic captive generating units. The Project also will contribute substantially to the development of small-scale and supporting industries in the Project area, which is accorded high priority in the Government's plan for regional development. Eventually, it is planned to connect Maninjau facility with the West Sumatra system currently being developed, which will help stabilize the delivery of power to a major part of this important province. The financial and economic rates of return of the Project are estimated at about 12 percent and 15 percent, respectively.

Date approved: April 8, 1976 (ADB).

TRANSPORTATION: To finance the foreign exchange cost of: (i) civil works for the betterment of 185 km of provincial and district roads in Central and East Java provinces and the reconstruction or improvement of about 30 bridges; and (ii) consultant services.

Borrower: Republic of Indonesia, Directorate General of Highways (DGH), Ministry of Public Works and Electric Power (MPW).

Loan: $20.0 million (Ordinary Capital); 25 years including a grace period of 5 years, at 8¾ percent per annum. Total project cost: $37.4 million.

Purpose and Benefits: The Gresik-Surabaya road portion of the Project in East Java crosses a densely populated area of Surabaya. The road is congested at present and would become worse due to the burgeoning industrial area between Surabaya and Gresik. The area to be covered by the Project in Central Java is relatively less densely populated and less developed than other areas in Java, with a poor communications network. Economic activities in the Project area in Central Java are predominantly agricultural with rice, maize, cassava and sweet potatoes as main products. Other major activities include forestry, a cigarette factory, an oil refinery, cement and fertilizer plants. The Project will contribute to further development of these activities and provide improved communications to the area's population and commercial hubs, the cities of Semarang and Surabaya. The Project will provide support to the agricultural and industrial sectors and help integrate the isolated population centers and rural areas in the region of high development potential. The Project will facilitate the flow of traffic of goods and services to the growing cities of Semarang and Surabaya and serve as a communication network for some eight million people in the Project area. The economic internal rate of return (EIRR) of different road links varies between 18 percent and 50 percent, with the overall EIRR being 25 percent.

Date approved: April 13, 1976 (ADB).

KOREA

TRANSPORTATION: The loan will help finance the Road Improvement Project. The project involves: (a) improvement of 11 sections of national highways and one provincial road section, totalling 409.7 km, mainly on present alignments, to two-lane paved standard; (b) construction of 3,500 meters of new reinforced concrete bridges to replace substandard existing bridges on those road sections; and (c) consultant services for construction supervision.

Borrower: Republic of Korea.

Loan: $43.0 million (Ordinary Capital); 23 years (including a 3-year grace period) at 8¾ percent interest per annum. Total project cost: $89.2 million equivalent.

Purpose and Benefits: The project is an integral part of the Korean Government's plan to bring the national highway network into step with the accelerated development of the national economy. It has been included in the third Five-Year Plan (1972–1976) and has been accorded high priority by the Government. Specifically, it will provide support to the agricultural sector so as to reach self-sufficiency in food production, and to help integrate the more isolated population centers and rural provinces in the south of the country with the larger towns and cities. As all of the road sections under the project are presently gravel surfaced and in unsatisfactory condition, the project paving and other road improvements would greatly reduce road-user costs. Geometric design standards of the roads are appropriate for speeds ranging between 40 to 80 km per hour, depending on terrain constraints. The pavement width will vary between 6.2 to 7.2 meters, also depending on terrain constraints and as appropriate for traffic volume. Road shoulders will be 0.9 to 1.9 meters wide, as terrain conditions permit, with gravel surfacing. while side and other drains would be suited to rainfall run-off conditions. In addition, six village by-passes will be constructed in the project area which, altogether, will approximate the same distance as the roads that presently run through the villages. The discounted total annual savings, when offset

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against project costs, result in economic internal rates of return for the different road sections ranging from 43 percent to 18 percent. For the project as a whole, the weighted average return rate is calculated at 29.9 percent.

Date approved: August 19, 1975 (ADB)

INTERMEDIATE CREDIT INSTITUTION: The loan will cover part of the medium- and long-term foreign exchange resource gap of the Korean Development Bank (KDB) during 1976 and 1977. KDB is a government-owned development finance institution, established in 1954, for the purpose of promoting industrial development in line with Government policies. So far, KDB has received three Bank loans totalling $60 million for relending to industrial enterprises in Korea. In addition, the Bank has provided a project-tied loan to KDB for relending to Hyundai International Inc. for a machinery manufacturing project.

Borrower: Korea Development Bank (KDB).

Loan: $40.0 million (Ordinary Capital); 15 years (including a 3-year grace period) at 8¾ percent interest per annum.

Purpose and Benefits: KDB-financed projects have a substantial socio-economic impact. During 1974, about 59,000 new jobs, equivalent to 13 percent of total new jobs in the country were attributable to KDB's operations. For the same year, 39 percent of the additional foreign exchange that accrued to Korea came from KDB client companies. KDB has supported the Government's policy of encouraging industries to locate away from the two major cities of Seoul and Busan. While in 1972 45 percent of all KDB's operations were concentrated in these two cities, this percentage decreased to 42 percent in 1973 and 34 percent in 1974. Companies assisted by KDB accounted for 30 percent of the incremental sales during 1974 of the mining and manufacturing sectors. KDB is instrumental in mobilizing and funnelling sizeable amounts of corporate savings into productive investment. KDB's lending operations have about doubled since 1972. The Bank loan will partially assist in filling KDB's foreign exchange resource gap of $170 million equivalent (commitment basis) during 1976 and 1977, and the loan is expected to be fully disbursed by the end of 1978. KDB intends to meet the balance of its foreign currency requirements through resources currently available from the World Bank, through loans from the Kreditanstalt fur Wiederaufbau and syndicates of foreign commercial banks, and through issues floated abroad on its behalf.

Date approved: November 25, 1975 (ADB)

MINING: The loan will finance the foreign exchange cost of a project to rehabilitate and expand the existing coal mines of the Dai Han Coal Corporation (DHCC). The project includes: (a) procurement of mining equipment and facilities such as compressors, dozers, shovels, excavators, rotary dump trucks, locomotives, tunneling machines, ventilation facilities, pumps and safety equipment; and (b) provision of foreign technical experts to assist DHCC with preparation of a long-range operating program for the development of its coal mines.

Borrower: Dai Han Coal Corporation (DHCC).

Loan: $12.0 million (Ordinary Capital); 15 years (including a 3-year grace period) at 8¾ percent interest per annum. Total project cost: $19.2 million equivalent.

Purpose and Benefits: Domestic demand for coal in Korea is expected to grow at an annual rate of 6.7 percent from 14.9 million tons in 1974 to 23.5 million tons in 1981. The current production level is somewhat above 15 million tons, and the Government has mounted a program to increase it to 24 million tons by 1981. One objective of the program is to avoid costly imports of crude oil by developing coal—Korea's only major domestic energy resource. Korea has proven coal reserves adequate for 23 years at projected mining rates, but its total reserves are estimated to be more than twice its proven reserves. Due to the quality of Korea coal (anthracite), its predominant use is as household fuel. Currently, coal supplies about 63 percent of household fuel needs, and firewood supplies 30 percent. The Government's program, of which the project is part, is expected to encourage greater substitution of coal for firewood and result in preservation of 33,420 hectares of forest annually. This will decrease atmospheric pollution, since the anthracite coal to be consumed has a considerably lower smoke emission characteristic than firewood. In 1975, DHCC accounted for 29 percent of Korea's total coal production. The company currently has proven reserves equivalent to 15 years of operation at post-project production rates. Completion of the project will lessen work stoppages at DHCC's mines caused by machinery failure, and improve safety standards. Both effects will increase production and reduce costs, as well as benefit company employees and their families. In addition, the project is expected to generate cumulative foreign exchange savings of $453 million over its economic life. The economic benefits of the project accrue from the increased coal output and are considerably in excess of economic costs, thus yielding an eonomic rate of return of 98.8 percent over the working life of the project. This exceptionally high rate of return illustrates the importance of the project to Korea's economy, given continuation of the high cost of imported fuels.

Date approved: March 30, 1976 (ADB)

DFC: The purpose of this project is to augment the foreign exchange resources of the Korea Development Finance Corporation (KDFC) to enable it to meet the medium- and long-term credit requirements of private industrial enterprises.

Borrower: Republic of Korea, Korea Development Finance Corporation (KDFC).

Loan: $40.0 million for 15 years including a grace period of 3 years at 9.10 percent interest per annum.

Purpose and Benefits: The proceeds of the loan will be utilized by KDFC to extend loans to productive enterprises operating primarily in manufacturing and processing industry in the private sector. The loan presents some specific development features which are expected to have an impact on the development of local industry, as well as on the geographical spread of KDFC's operations to less developed areas of the country. KDFC will maintain the interest rate on its subloans under the loan at a level which will provide KDFC with a minimum spread of 2 percent per annum. Considering the standard of KDFC's appraisal work, quality of portfolio, the average size of loans and financial performance, the free limit of subloan will be increased to $1.5 million and the ceiling of debt equity ratio will be raised to 8.5:1. The maximum financial assistance which KDFC can extend to any single enterprise is limited in the Policy Statement of KDFC to 25 percent of its equity which is, under the present situation, about $3.7 million. Procurement under the subloan will be in accordance with acceptable procedures so that goods will be purchased at reasonable prices taking into account various relevant factors such as time of delivery, efficiency and reliability of the goods and availability of maintenance facilities and spare parts. The loan will have a fixed amortization schedule. KDFC will protect itself against foreign exchange risk by initially passing it on to the sub-borrowers and while funds from repayments are in the hands of KDFC, by maintaining these funds in appropriate foreign exchange.

Date approved: June 22, 1976 (ADB)

MALAYSIA

POWER: The loan funds will help finance the foreign exchange cost of the Third Sarawak Electricity Supply Project, which consists of: (a) construction of a power station incorporating three diesel generating sets at Kuching; (b) installation of two diesel generating sets at Sibu; (c) construction of a transmission system, and (d) consultant services for construction/supervision and a study of the tariff structure.

Borrower: Malaysia.

Loan: $22.7 million (Ordinary Capital); 20 years (including a 5-year grace period) at 8¾ percent interest per annum. Total project cost: $31.5 million equivalent.

Purpose and Benefits: The project will expand the electricity supply systems in Kuching and Sibu. Kuching is the State capital, with a 1972 population of about 230,000. The State Government has actively promoted development of an industrial zone in the north of Kuching, and a number of new factories are expected to become operational within a few years. On the north bank of the Sarawak River, a large area has been set aside for development of a new administration and business center, including the construction of the Council Negri Assembly Hall, Government Secretariat Building, industrial estates and a commercial complex. Reflecting these developments, the population in Kuching is expected to increase by over 6 percent annually, and more than 13,000 new houses are planned to be built by 1980. Altogether, electricity demand is expected to increase by 20 percent annually over the next five years. Present installed capacity can meet demand only up to the end of 1976. Sibu is the second largest town of Sarawak with a population in 1972 of about 110,000. The town is noted as a center of timber industries. The population of Sibu, together with a large pulp mill and a number of other timber-based industries, are expected to increase their demand for electricity by 21 percent annually up to 1980, and exceed the present generating capacity at the end of 1975. The incremental financial internal rate of return for the project is estimated at 9 percent and its economic rate of return is estimated at 11 percent.

Date approved: August 26, 1975 (ADB)

TRANSPORTATION: The loan will help finance the foreign exchange cost of a project to: (a) construct approximately 173.8 km of road network; (b) provide consultant services for construction supervision; and (c) provide eight expatriate professional staff to strengthen the executing agency, the Trengganu Tengah Development Authority (LKTT).

Borrower: Malaysia.

Loan: $23.7 million (Ordinary Capital); 25 years (including a 4-year grace period) at 8¾ percent interest per annum. Total project cost: $42.2 million equivalent.

Purpose and Benefits: The Trengganu Tengah Development Scheme is accorded high priority by the Government because of its potential for contributing significantly to Malaysia's economic growth and to a more balanced regional distribution of income and social benefits. The Scheme envisions converting largely underdeveloped forest into a commercial agricultural area that produces mainly oil palm and rubber, the establishment of forest complexes, the development of agro-based industries, the establishment of eight new towns to be settled by about 100,000 people by 1990, and the provision of infrastructure and social services. Since the project road network is an integral part of the required infrastructure for the development area, proper and timely implementation of its construction is vital to the overall scheme. The role of LKTT in implementing the planned development is of great importance and the strengthening of its organization is urgently required. The economic internal rate of return of the road component of the project is estimated at 16.7 percent.

Date approved: November 13, 1975 (ADB)

NEPAL

MANUFACTURING: The credit proceeds will supplement a previous Bank loan for $2.0 million (Ordinary Capital), authorized December 10, 1970, and a previous Bank credit for $2.0 million (Special Funds), authorized December 10, 1970. The supplement will finance part of the foreign exchange portion of a cost overrun on a jute mill development project.

Borrower: Kingdom of Nepal.

Loan: $0.5 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Change in total project cost: From $5.1 million equivalent to $5.6 million equivalent.

Purpose and Benefits: Although its jute industry is a major foreign exchange earner for Nepal, it was a sector neglected in Government development efforts prior to 1970. The project is part of the high priority jute development program the Government has since initiated, and includes: integrating the production of jute, rationalizing the marketing and trading of raw jute; modernizing two existing jute mills; and the consultant services of specialists in jute production. The cost overrun was due to delays caused by difficulties in finding satisfactory consultants, and to the necessity of having to reopen the bidding on some machinery and equipment contracts because the inital bids were unacceptably short of specifications. The rate of returns estimated for the project are unchanged, at 19 percent for the financial rate of return (after taxes) and 18 percent for the economic rate of return.

Date approved: October 2, 1975 (ADB)

TRANSPORTATION: The credit will help finance a project to improve the Tribhuvan International Airport (TIA) in Kathmaudu, consisting of: (a) rehabilitation of the existing runway and taxiway; (b) preparation of a long-term program for the location of various terminal buildings at the airport and detailed engineering designs of terminal buildings; and (c) consultant services to assist in project implementation.

Borrower: Kingdom of Nepal.

Loan: $10.0 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Total project cost: $12.8 million equivalent.

Purpose and Benefits: TIA is the main international airport for Nepal; it is the port of entry for over 80 percent of the country's tourists. TIA is linked with other Asian cities and thus to international air routes. It also is the hub of Nepal's domestic traffic. Owing to the rugged terrain, domestic air service is the major link be-

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tween the remote interior and Kathmandu, the capital, and, therefore, plays an important role in the economy of the country. The present conditions of TIA's existing runway and taxiway show extensive deterioration, which worsen with each monsoon season; emergency repairs and overlay are needed urgently. Moreover, so that capacity constraints do not adversely affect the growth of traffic expected in the future, investments in expansion of TIA's facilities must be undertaken now. If the emergency repairs and expansion are not undertaken soon, international air traffic to Kathmandu will come virtually to a complete halt within the next few years as large aircraft of the type presently using TIA will be unable to continue using it safely. Land travel to Nepal involves considerable time and inconvenience, and the termination of flights to TIA would have a major adverse impact on tourism. The significance of this impact is evident from the fact that tourism now accounts for one-fifth of Nepal's convertible foreign exchange receipts. The project will help to avoid this possible loss and will sustain growth in tourist traffic. The difference in the earnings from tourism with and without the project was used to quantify the project's benefits. More specifically, the quantified economic benefits consist of: (a) revenue from aircraft landing fees; (b) revenue from passenger service fees; and (c) income from tourist expenditures. The economic internal rate of return, estimated on the basis of the above costs and benefits, is 35 percent. The project will supplement investments under an earlier ADB loan, which included, among others, extension of the runway, taxiway and parking apron to accommodate larger jet aircraft.

Date approved: October 2, 1975 (ADB)

POWER: The credit will supplement a previous Bank credit for $2.7 million, authorized October 24, 1972. The supplement will finance the foreign exchange component of a cost overrun.

Borrower: Kingdom of Nepal.

Loan: $2.5 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Change in total project cost: From $3.6 million equivalent to $7.5 million equivalent.

Purpose and Benefits: The cost overrun was due to price increases as a result of inflation and other adverse developments in the world economy. The project—the Gandak-Hetauda Power Project—consists of construction of 150 km of transmission lines and a substation, expansion of the capacity of another substation, and consultant services. Although the economic rate of return has declined from 25 percent to 17.2 percent, the lower rate was acceptable to the Bank.

Date approved: December 11, 1975 (ADB)

POWER: The credit will finance the foreign exchange cost of the Second Power Project, which consists of: (a) construction of an extension line and associated substations; and (b) consultant services for (i) project implementation and (ii) an institutional study of Nepal's power sector.

Borrower: Kingdom of Nepal.

Loan: $3.8 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Total project cost: $5.4 million equivalent.

Purpose and Benefits: The Pokhara Valley, a tourism and agricultural center with a population of 32,000, has been experiencing a power shortage since the recent collapse of a hydropower dam feeding the power station there. The project is designed to extend power transmission from Bharatpur to meet Pokhara's needs. Although the collapsed dam is being reconstructed, it is estimated that the demand for power will exceed the capacity of its power plant in the next few years. The project will link Pokhara to the Central Nepal Power System and thereby assure reliable power for the area using the most economic alternative. Adequate electrical power will stimulate the development of agriculture and light industry, sustain the progress made in existing industrial centers, and lessen the need for the cutting of trees for fuel that results in soil erosion. The financial rate of return is estimated at 10.3 percent.

Date approved: December 11, 1975 (ADB)

PAKISTAN

POWER: The credit will finance the foreign exchange cost of a project that is the next stage of a program to expand the generating capacity of the Karachi Electric Supply Corporation (KESC) system. The project consists of: (a) construction of a generating station consisting of three or four, simple cycle gas turbines; (b) related substation and communications equipment; and (c) consultant services for project implementation.

Borrower: Islamic Republic of Pakistan.

Loan: $22.0 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Total project cost: $30.9 million equivalent.

Purpose and Benefits: The gas turbine station is needed urgently to meet the present power demand and forecasted load growth in the Karachi area. Present generation capacity is not enough to meet the daily peak demand which occurs for about four hours in the evening. Demand is projected to grow at an annual rate of 14 percent over the next eight years. The project will increase KESC's installed capacity by almost 20 percent. KESC is one of two power utilities that together supply 90 percent of Pakistan's power. The gas turbine installation was carefully compared with alternative generation facilities, particularly diesel units or smaller steam units, and was found to be the least costly and most technically appropriate solution. Gas turbines have the advantages of lower cost per installed kilowatt, shorter delivery and installation time and rapid start characteristics. A capacity range was selected that encompasses the standard production units of the major manufacturers, which is expected to encourage wide international competitive bidding. Division of the total installed capacity into either three or four units will provide flexibility by allowing individual units to be operated at full load, and will further facilitate the programmed maintenance of the units. The proposed units will be of the package type and will be designed for "dual fuel" operations—either natural gas or light diesel oil. Natural gas will be the primary fuel while light diesel oil will be used only in the event of a failure or a limitation in gas supply. The project will support further development of economic and industrial activities in Karachi, which continues to expand at a very high rate. It also will enable KESC to supply bulk power to the Hyderabad area. The economic rate of return on the project is estimated to be 19 percent and the financial rate of return is estimated at 13 percent.

Date approved: August 26, 1975 (ADB)

MANUFACTURING: This loan and credit will help finance a project to establish a complete and integrated ammonia/urea fertilizer complex. The project consists of: (a) the design, engineering and construction of a 1,000 ton-per-day ammonia plant and a 1,740 ton-per-day urea plant; (b) construction of auxiliary utilities and supporting facilities to serve the plants; (c) construction of office and plant buildings and staff housing; and (d) engineering services and technical assistance.

Borrower: Islamic Republic of Pakistan.

Loan: $50.0 million ($12.0 million Special Funds for 40 years, including a 10-year grace period, with a service charge of 1 percent per annum; $38.0 million Ordinary Capital for 15 years, including a 4-year grace period, at 8¾ percent interest per annum). Total project cost: $196.4 million equivalent.

Purpose and Benefits: The project, which is scheduled to start commercial operations by April 1978, will help Pakistan achieve self-sufficiency in nitrogenous fertilizers by 1979, provided the project and another plant proposed for Fauji are on stream by then. For a period of about seven years after 1978, there will be surplus local production before demand again will exceed local supply. The average cost of urea production of the project is calculated at $86.70 per ton in 1980/81 at 90 percent operating capacity and $60.90 per ton in 1991/92 at 100 percent capacity. This compares to an ex-factory gate price assumed conservatively at $121 per ton. These cost levels will be very competitive with projected world market prices. A recent survey indicates that a deficit of nitrogenous fertilizer is likely to continue in several Asian countries such as India, Burma, Thailand, Malaysia and the Philippines, despite new investments in production capacity now underway. Since natural gas is now substantially cheaper than other feedstocks for the production of nitrogenous fertilizer, Pakistan should be able to export urea at competitive prices. At 90 percent capacity utilization, the project would produce 516,780 tons of urea per annum. If imported, this would cost about $75.5 million in foreign exchange. Deducting $18.3 million required annually as total foreign exchange component of cash production costs and capital charges, the country will save net foreign exchange of $57.2 million each year. The financial rate of return of the project would be 14.7 percent, a moderate but satisfactory level, while the economic rate of return has been calculated at 16.0 percent.

Date approved: December 18, 1975 (ADB)

INTERMEDIATE CREDIT INSTITUTION: The loan will be the third line of credit extended by the Bank to augment the foreign exchange resources of the Industrial Development Bank of Pakistan (IDBP) so that it can meet the medium- and long-term credit needs of small- and medium-scale industries in Pakistan's private sector.

Borrower: Industrial Development Bank of Pakistan (IDBP).

Loan: $25.0 million (Ordinary Capital); 15 years (including a 3-year grace period) at 8¾ percent interest per annum.

Purpose and Benefits: IDBP is the major source of foreign exchange to Pakistan's small- and medium-scale industrial sector, to which it makes loans on medium- and long-terms. As of 31 August 1975, IDBP had a backlog of 58 projects awaiting commitments or approvals, involving a total of $41 million in foreign exchange. Against this requirement, IDBP had no untied foreign exchange resources available. IDBP's foreign exchange requirements for the next three years are estimated at $64 million, including projects now in its pipeline. IDBP is expected to utilize the $25 million loan from the Bank in about 24 months. The loan will be relent to sub-borrowers at a rate which assures IDBP of a minimum spread of 2 percent per annum. IDBP is required to submit all individual sub-loan applications for $300,000 or more to the Bank for review before committing itself. The Bank is satisfied with IDBP's utilization of its two earlier Bank loans.

Date approved: December 23, 1975 (ADB)

WATER SUPPLY: This loan will help finance the foreign exchange costs ($20.0 million) including engineering services, financial and management consultant services and part ($2.0 million) of the local currency costs for the improvement and expansion of the water supply and sewerage system of Greater Hyderabad.

Borrower: Islamic Republic of Pakistan, Sind Development Authority.

Loan: $22.0 million (Special Funds), 40 years including grace period of 10 years at 1 percent per annum. Total project cost $34.7 million.

Purpose and Benefits: The Project comprises a water supply scheme and a sewerage scheme. The objective of the proposed water supply scheme is to provide safe piped water supply to all residents of the project area and to meet the increasing water demand. The proposed water supply scheme will increase the capacity of water treatment facilities from the present capacity of 64,000 cu.m./day to 200,000 cu.m./day with the construction of a new treatment plant having a capacity of 136,000 cu.m./day. The additional capacity is estimated to meet demands up to 1987 for Greater Hyderabad. The existing distribution system will also be substantially strengthened and extended under the scheme. The new water treatment plant will be a conventional complete works comprised mainly of a rapid mixing basin, floculation-sedimentation system, rapid sand filters, chemical feeding facilities, and clear water reservoirs. To supplement the existing 792 public standposts (more than 25 percent of which need to be repaired or replaced) within Hyderabad, the proposed water supply scheme will include the installation of about 490 standposts to expand the area of coverage for the poor residents, particularly in areas where the distribution network is not adequate and where it is impossible to depend on wells due to the salinity of groundwater. About 250,000 people are now served from public standposts and it is estimated that this number will increase to 400,000 after the additional standposts will be in operation.

Dated approved: April 13, 1976 (ADB)

DEVELOPMENT FINANCE COMPANY: This loan will augment the foreign exchange resources of The Pakistan Industrial Credit and Investment Corporation (PICIC) to meet the medium- and long-term credit requirements of medium- and large-scale industries in the private sector.

Borrower: Islamic Republic of Pakistan, The Pakistan Industrial Credit and Investment Corporation Ltd. (PICIC).

Loan: $25.0 million; the amortization schedule of the proposed loan will conform substantially to the aggregate of the amortization schedules applicable to the sub-loans. Each sub-loan will be made for a maximum term of 15 years including a grace period not exceeding 3 years. Interest at 9.10 percent.

Purpose and Benefits: The scope and nature of PICIC's operational policies are governed by its Outline of Business Policies. PICIC provides financial assistance to the private industrial sector through (i) medium- and long-term loans, (ii) equity participation, (iii) underwriting of public issues of equities, (iv) joint financing with other development finance institutions in the country, and (v) arranging for direct financial assistance by foreign invest-

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ors. The terms of PICIC's loans have been in the range of 10 to 15 years including a grace period of two to three years with the exchange risk passed on to the borrowers. For foreign exchange loans, PICIC has been applying varying interest rates depending on the source of finance. Effective from September 1975, PICIC increased its interest on foreign exchange loans irrespective of the source of finance involved. For local currency loans an interest rate of 9.5 percent per annum is applied for financing of locally fabricated machinery, while for other local currency lending, 13 percent per annum is charged for projects in the developed regions against 12.5 percent per annum for projects in the less-developed regions. The maximum amount to be extended by PICIC from the proceeds of the Bank loan for any individual sub-loan, however, will not exceed $4 million. PICIC's appraisal procedures are well established, sound and appropriate, and its appraisal standards are high.

Date approved: June 29, 1976 (ADB)

PHILIPPINES

TECHNICAL ASSISTANCE: The loan will help finance the foreign exchange costs of consultant services necessary to prepare for a project to improve 960 km of secondary and feeder roads on the island of Mindanao: (a) a feasibility study; (b) detailed engineering design; and (c) specifications and tender documents.

Borrower: Republic of the Philippines.

Loan: $0.5 million (Ordinary Capital); 10 years (including a 2-year grace period) at 8¾ percent interest per annum. Total project cost (project preparation): $1.3 million equivalent.

Purpose and Benefits: This technical assistance is needed to determine the nature and extent of improvements required for the road improvement project, which may be considered for Bank financing in the future. The project road improvements would greatly benefit the rural, mostly low income population of northern and southwestern Mindanao. They also are expected to result in direct benefits to road users, and to stimulate greater economic activity. The improvements, particularly to the selected feeder roads, would be a logical next step for Bank financing of other roads in Mindanao, and would complement earlier Bank investments in two highway projects now under construction. The feasibility study also would evaluate the social impact of the proposed road improvements, and the resultant project is expected to expand the benefits accruing from the earlier Bank-financed Cotabato Port Project.

Date approved: August 14, 1975 (ADB)

ENVIRONMENTAL QUALITY: The proceeds of this loan will finance the foreign exchange cost of the Laguna de Bay Development Project—a project to protect, improve, and develop a major lake as a critical resource. The project consists of: (a) constructing a hydraulic control structure connecting Laguna de Bay to the Pasig River outlet to Manila Bay, which will protect Laguna de Bay from salt intrusion and industrial pollution; (b) constructing four lakeshore irrigation projects totalling 15,000 hectares; (c) implementing feasibility studies for the Lake's West Shore and the East Marikina interceptor sewers and doing detailed studies for water control and management; (d) carrying out feasibility studies for additional irrigation projects; and (e) consultant services.

Borrower: Republic of the Philippines.

Loan: $27.5 million (ordinary capital); 30 years (including a 6-year grace period) at 8¾ percent interest per annum. Total project cost: $45.2 million equivalent.

Purpose and Benefits: The project area has substantial potential for further development to accommodate an expected population growth from 6 million currently to 15 million by the year 2000. The Lake, one of the largest in Southeast Asia, has vast potential as a resource for agriculture, for fisheries and for accommodating domestic and industrial water demands. It also has potential for mitigating the chronic flood problem in Greater Manila and the surrounding countryside if proper control measures are established. However, serious constraints to such developmental use of the Lake exist due to problems of salinity; water pollution; contamination from industrial, human, and animal waste; periodic massive growth of algae; recurrent flood damage; and lack of water management and irrigation facilities. If these conditions are not dealt with immediately, the Lake soon will be unusable. Consequently, the Government has given the project high priority. The proposed project is expected to result in 100,000 tons of incremental paddy production after 1985, valued at $7.9 million annually; savings from averting losses in fishpens ranging up to $1.4 million in 1985; and increases in farmers' income from $250 annually to $1,380 (leaseholder) or to $1,558 annually (owner-operator). With the incremental income, farmers would pay water charges estimated at $100 per farm or about 7 percent of the incremental net income from irrigation project. If the rice consumed by farmers is added to the amount marketed, resultant reductions in rice imports are expected to generate annual foreign exchange savings of $15.7 million. In addition, there will be substantial savings on reduced flood damage. Employment benefits extend to 2.3 million man-days needed during construction and 1.8 million man-days annually thereafter. The economic rate of return from the hydraulic structure is estimated to be 14.1 percent and from the irrigation works 14.3 percent.

Date approved: December 9, 1975 (ADB)

INTERMEDIATE CREDIT INSTITUTION: The loan will be on-lent to augment the foreign currency resources the Development Bank of the Philippines (DBP) needs through 1977 to meet part of the foreign currency requirements of medium and large manufacturing and mining industries. The DBP is the largest long-term development financing institution in the country, and its operations cover virtually all sectors of the economy. It is involved in agriculture, forestry, fisheries, livestock, transportation, including shipping, industry and mining, real estate and private development banks, and it also is involved in a host of promotional activities.

Borrower: Republic of the Philippines.

Loan: $25.0 million (Ordinary Capital); 15 years (including a 3-year grace period) at 8¾ percent interest per annum.

Purpose and Benefits: Economic activity in the Philippines traditionally has been the domain of private initiative. A strong private sector has developed, which pervades the entire economy but centers in the industrial sector. Industry (including mining and construction) presently is the third largest sector of the economy, contributing about 26 percent to the net national product in 1974 and employing 1.4 million persons—about 10 percent of the labor force. It accounts for over one-third of annual gross domestic capital formation. Manufacturing, which accounts for more than two-thirds of all industrial activity, consists of relatively large scale units, mostly in the food and beverages, chemicals and petrochemicals, and textiles sub-sectors. More than half of the industry in the country is located in the Greater Manila area, due partly to the fact that other regions lack adequate infrastructure facilities. Initially, industrial development in the Philippines essentially was import substitution of finished consumer goods with a low average of domestic value added content, and based on imported inputs, components and capital goods highly protected by import tariffs. However, assisted by Government incentives, the sector is adjusting to a changed environment and DBP assists this effort by directing much of its available funds toward potential exports and improving the efficiency of existing plant and equipment. In the past two years, DBP's financing accounted for about 13 percent of total fixed capital formation in the country, and its industrial financing accounted for about 26 percent of the total fixed capital formation in the manufacturing and mining sector.

Date approved: December 9, 1975 (ADB)

WATER SUPPLY: The loan will aid the financing of a project to improve and extend the drinking water supply systems of five provincial water districts in Mindanao, Luzon and the Visayas. The project includes: (a) expansion and improvement works of water supply facilities for the Butuan City, Camarines Norte, Misamis Occidental and Zamboanga City Water Districts, including (i) source development, (ii) treatment works, (iii) transmission pipelines, and (iv) extension of distribution systems; (b) interim improvements to source and transmission mains, (c) detailed engineering design for a major dam, treatment works, transmission and distribution mains; (d) preparation of a master plan for a watershed reforestation and erosion prevention project, all for the Metropolitan Cebu Water Districts; (e) overseas training of selected staff from the Local Water Utilities Administration (LWUA) and the five project water districts mentioned above; and (f) consultant services.

Borrower: Republic of the Philippines.

Loan: $16.8 million (Ordinary Capital); 26 years (including a 6-year grace period) at 8¾ percent interest per annum. Total project cost: $35.6 million equivalent.

Purpose and Benefits: At present, only half the population of the Philippines benefits from reliable potable drinking water, although the country's resources are sufficient to accomodate all foreseeable needs. The project will: (a) alleviate the poor supply conditions detrimental to health; (b) extend supply to persons not served and provide for demand growth; (c) improve health by replacing unsafe shallow wells with piped treated water; (d) remove a major constraint on economic growth in the project cities. The project respresents the first major expansion of the systems since their original installations (in the period 1911 to 1949) and is long overdue. The scheme proposed for each water district represents the least-cost solution. The consultants have investigated all alternative supply sources, carried out computer analysis of existing and proposed storage facilities, transmission and distribution mains to optimize their proposals. The project represents the first phase of construction under a long-term master plan for each water district. All schemes have been agreed to by the respective water districts and LWUA as being appropriate to local needs and conditions. The water districts in the project, currently range in population from 36,000 to 405,000 persons, who will benefit from its implementation.

Date approved: December 16, 1975 (ADB)

TRANSPORTATION: This loan will help finance the foreign exchange costs of a Philippine National Railways Project. The project includes: (a) rehabilitation of 474 km of track and bridges on the Southern Line between Manila and Legaspi; (b) maintenance equipment for track and bridges; (c) rehabilitation of the entire mainline communication system and related equipment; (d) equipment for rolling stock maintenance; and (e) consultant services to assist with implementation of project works and in improving the overall managerial performance and efficiency of the Philippines National Railway (PNR).

Borrower: Republic of the Philippines.

Loan: $24.2 million (Ordinary Capital); 20 years (including a 5-year grace period) at 8¾ percent interest per annum. Total project cost: $33.4 million equivalent.

Purpose and Benefits: The Southern Line presently accounts for about 62 percent of total freight traffic and 85 percent of total passenger traffic in the Bicol corridor, excluding purely local traffic which is carried mostly by road. The Bicol region accounts for about 6 percent of the Philippine's total land area, 8 percent of its population, 3 percent of its forest area, and 6 percent of its manufacturing establishments. The region's basic economy is agriculture, which accounts for 75 percent of its land area and 61 percent of its labor force. An intermodal comparative cost analysis indicates that if the Railway can achieve certain modest and reasonably attainable improvements in operating efficiency, railway transportation will be the cheapest mode of transporting freight between many of the most important destinations in the Bicol corridor, notably Manila-Naga. Currently, the Southern Line is hampered by numerous speed restrictions and periodic shut downs that are due to the poor conditions of the track and wooden bridges. The planned rehabilitation will reduce travel time between Manila and Legaspi by 30 percent for fast passenger trains, and by 42 percent for freight trains, and make the railway fully competitive with road transport. Taking into account all anticipated changes in the transport system in the Region, as well as expected improvements in operational efficiency for all modes, it is estimated that, while rail traffic should decrease in relative importance in the corridor, it should contine to grow in absolute terms. The most probable estimates of traffic growth indicate that over the next ten years freight traffic could rise by about 7.4 percent per annum and rail passenger traffic by 1.5 percent. In order to realize this growth in traffic, as well as the savings in transport costs against carrying the same traffic by road, the Southern Line will need to be rehabilitated, and certain improvements in organizational structure and operational practices must be introduced.

Date approved: March 25, 1976 (ADB)

DEVELOPMENT FINANCE CORPORATION: These loan funds are for relending to Private Development Corporation of the Philippines (PDCP) to extend loans to meet the foreign currency requirements of private industrial enterprises in the Philippines.

Borrower: Philippine National Bank, Private Development Corporation of the Philippines (PDCP).

Loan: $25 million (Ordinary Capital). Repayment will conform substantially to the aggregate of the amortization schedules, which will not exceed 15 years. Interest at 9.10 percent.

Purpose and Benefits: PDCP had, during 1969–1973, received three loans from the ADB, totalling $45 million. The full amount of the first loan was committed in about 39 months and the second loan in about 36 months. As of 31 December 1975, PDCP had committed about 87 percent of the third loan and is expected to commit the

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balance soon. Under the first loan, chemical products, communication and non-metallic mineral products were the principal recipients of sub-loans by amount. Under the second loan, the main beneficiaries were chemical products, wood industries, food processing and electrical machinery manufacture. The main beneficiaries under the third loan were textiles, chemical products, shipping, and agriculture and fisheries. It is estimated that the sub-projects financed by the second loan ($15 million) will generate 5,363 additional jobs, and those under the third loan ($25 million) so far, 3,363 jobs, compared with the estimated 859 jobs created under the first Bank loan ($5 million). It is also estimated that the annual foreign exchange earnings/savings by sub-projects under the three Bank loans will be about $18 million, $35 million and $38 million, respectively. PDCP has estimated its foreign currency requirements at $119.8 million equivalent on a commitment basis during 1976–1978, the expected period of utilization of the proposed Bank loan. At the beginning of 1976, PDCP had unallocated foreign currency resources of $24.6 million ($19.7 million from the fourth IBRD loan, $1.9 million from the third Bank loan and $3 million from other sources). PDCP expects to fully utilize these resources by October 1976 when the proposed Bank loan is likely to become effective, if approved. In addition, PDCP expects to receive a loan of $20 million by mid-1976 from an IFC-led consortium. PDCP plans to use both the proposed Bank loan and the IFC loan simultaneously in the next two years.

Date approved: June 25, 1976 (ADB)

SINGAPORE

WATER SUPPLY: The principal components of this project are: (i) Construction of the Western Catchments Scheme; (ii) construction of two service reservoirs; (iii) laying of transmission, distribution and internal network mains; (iv) purchase of water meters; and (v) consultants' services for the design and supervision of the Western Catchments Scheme.

Borrower: Public Utilities Board (PUB).

Loan: $23.6 million; (Ordinary Capital) 20 years at 9.5 percent per annum. Total cost $62.2 million.

Purpose and Benefits: With improved and expanded public housing programs and continued development of economic activities, there have been corresponding increases in water demand. To meet the growing demand of the social and economic sectors, Singapore must continue its program for expanding water supply facilities. In addition, Singapore has achieved remarkable success in attracting foreign commercial establishments and industry to Singapore and the assurance of a reliable water supply has been and will continue to be, vital in this respect. The various project components have been identified by the Bank as being the most appropriate least-cost solution for the provision of major supply sources to Singapore in either the State of Johore or Singapore and significant savings are expected to accrue in the cost of treatment of the Kranji-Pandan water as a peripheral benefit under the project facilities. PUB's consultant has investigated and the Bank has concurred that the cost per cu. m. of water that would be produced from the combined Western Catchments and the Kranji-Pandan Scheme, is approximately US 8 cents per cu. m. as against recycling waste water at double this cost and desalinization of sea water at approximately five times this cost. The financial internal rate of return on the project on an incremental basis is 20.3 percent.

Date approved: April 13, 1976 (ADB)

SRI LANKA

MANUFACTURING: The credit will finance part of the foreign exchange cost of a project to establish a urea fertilizer plant to Sapugaskanda, which will be adjacent to the Ceylon Petroleum Corporation (CPC) refinery that will supply the project plant with naphtha and fuel. The project includes: (a) preparation of the site; (b) design, procurement of equipment for, and construction of (i) an ammonia unit with a design capacity of 540 tons per day (TPD), (ii) a urea unit with a designed capacity of 940 TPD, and (iii) utilities and supporting facilities for the ammonia and urea units; (c) a technical advisor for procurement and supervision of construction; (d) a management contractor to operate the plant for three years; and (e) management and financial consultants to assist the State Fertilizer Manufacturing Corporation (SFMC); and (f) training for SFMC staff.

Borrower: Republic of Sri Lanka.

Loan: $30.0 million (Special Funds); 40 years (including a 10-year grace period) with a service charge of 1 percent per annum. Total project cost: $152.0 million equivalent.

Purpose and Benefits: The project will help Sri Lanka achieve self-sufficiency in urea fertilizer until about 1986. During the initial years of the project, the output of urea will exceed domestic requirements and the surplus will be exported. Currently, imports of foodstuffs account for 40 percent of Sri Lanka's total imports, and mainly are rice, flour and sugar. These imports of rice cost about $116 million in 1974, and are expected to cost $129 million in 1975. The need to import foodstuffs which could be grown domestically reduces the import capacity of the economy for intermediate products and investment goods. The Government plans, therefore, to increase domestic paddy production through the use of additional fertilizer supplied by this project. At 90 percent of capacity, the project plant will produce 279,000 tons of urea annually, which would cost $41.8 million in foreign exchange to import. The total foreign exchange component of the project's cash production costs and capital charges are estimated at $31.8 million per annum. The difference between the two foreign exchange costs is a net annual foreign exchange savings for Sri Lanka of $10.1 million per annum. Based on economic prices for urea of $150 per ton for domestic sales and $120 per ton for export sales, and prices for naphtha and fuel oil of $100 per ton and $70 per ton, respectively, the economic rate of return on the project is estimated to be 11 percent. The after-tax financial rate of return is estimated to be 8 percent.

Date approved: September 18, 1975 (ADB)

THAILAND

INTERMEDIATE CREDIT INSTITUTION: The proceeds of this loan will assist the Industrial Finance Corporation of Thailand (IFCT) by supplying some of the foreign exchange necessary to meet the medium- and long-term credit requirements of private industrial enterprises in Thailand. IFCT essentially is a privately-owned development financing institution established in 1959 for the purpose of promoting private industrial investment.

Borrower: Industrial Finance Corporation of Thailand (IFCT).

Loan: $20.0 million (Ordinary Capital); 15 years (including a 3-year grace period) at 8¾ percent interest per annum.

Purpose and Benefits: During the initial stage of industrialization in Thailand, as in most developing countries, the Government took the initiative for the establishment of industrial projects. Subsequently, private interest in the industrial sector developed gradually with Government incentives and protection. At present, the private sector is responsible mainly for implementation of the Government's plan for industrial development. The private fixed investment portion of gross national investment averaged about 62 percent during 1971–73. Private investment increased by 17 percent in real terms in 1973 after a slow but continuous decline from 1970 to 1972, which was due to excess capacity in some manufacturing and service industries. Investment by the private sector as a percentage of GDP increased from 16 percent to 22 percent in the period from 1968 to 1974. Industrial development policies of the Government generally have been directed toward import substitution. However, during the current Third Five-Year Plan (1972–1976) more emphasis is being placed on development of labor-intensive, export-oriented and agro-based industries. IFCT, as the main source of medium- and long-term funds for private industry in Thailand, has been in the forefront of this progress, and is expected to continue its contributions to Thailand's industrial development. To date, IFCT has approved loans totalling $110 million equivalent for 280 projects. It is estimated that projects financed by IFCT from 1971 to 1974 will generate about 38,000 jobs. In addition, annual foreign exchange gains (exporter earnings plus import substitution) by IFCT-financed projects increased from $64 million equivalent in 1971, to $272 million equivalent in 1974. IFCT's operational projection indicates that loan approvals will increase from $32 million equivalent (including $21 million in foreign currency) in 1975 to $40 million equivalent (including $26 million in foreign currency) in 1978. In terms of commitments, total loans will amount to $148 million equivalent during 1975–1978, of which $96 million equivalent will be in foreign exchange and $52 million equivalent in local currency. Considering the level of approval in 1974 and IFCT's current pipeline of projects, the projections are reasonable and realistic.

Date approved: August 12, 1975 (ADB)

FISHERIES: The loan will help finance a project to modernize the pelagic fishing fleet through provision of 583 vessels to be locally constructed and outfitted with imported engines and equipment, and improvement of onshore facilities. The project comprises: (a) sub-loans by the Fish Marketing Organization (FMO) to finance (i) marine diesel engines and spare parts, (ii) ancillary generating units, (iii) navigational equipment and fish detectors, (iv) deck equipment, and (v) chilling equipment; (b) the construction of five ice-making and refrigeration complexes; (c) procurement of 32 refrigerated trucks; and (d) consultant services.

Borrower: Kingdom of Thailand.

Loan: $20.0 million (Ordinary Capital); 20 years (including a 4-year grace period) at 8¾ percent interest per annum. Total project cost: $40.9 million equivalent.

Purpose and Benefits: The project is accorded high priority by the Government and is compatible with the Government's development objectives and policies for the fisheries sector. It will: (a) assist fishermen to improve their economic condition by enabling them to increase their fish catch and thereby raise their incomes and standard of living, and (b) increase fish production for domestic consumption, especially in the north and northeastern regions, where per capita fish consumption is low. This will help to improve protein ingestion by the population, thus providing nutritional and health benefits. The project will increase income and employment for a large number of fishermen and others in associated activities, generating about 3,663 jobs. It also will facilitate the introduction of improved technology, particularly through the demonstrated use of modern purse seiners, which will have a significant impact on improving fish output and increasing profitability. The addition of freezing and storage facilities will have a stabilizing influence on fish prices to the benefit of both consumers and fishermen. The improvement of fish transportation (through the use of refrigerated trucks) will have nutritional and health benefits through wider distribution of this important protein source. The project includes an institution building element that will provide finance on reasonable terms to artisan fishermen, lessening their dependence on loans on onerous conditions. The estimated economic rate of return on the project is 32.3 percent, while the financial rate of return is 18.5 percent.

Date approved: December 11, 1975 (ADB)

TRANSPORTATION: The loan will help finance Thailand's Second Highway Project, which includes: (a) construction of approximately 90 km of two-lane highway to bituminized paved standards; (b) consultant services for the supervision of civil works contracts; and (c) consultant services to prepare a feasibility study, detailed engineering designs and tender documents for improvement of eight existing feeder roads in various parts of the country, totalling 457 km.

Borrower: Kingdom of Thailand.

Loan: $19.0 million (Ordinary Capital); 24 years (including a 4-year grace period) at 8¾ percent interest per annum. Total project cost: $31.4 million equivalent.

Purpose and Benefits: The project is an integral part of high priority effort the Government is making to close the gap between the adequacy of major trunk road networks and the accelerated development pace of the rural economy. Specifically, the project will provide support to the agricultural sector and help ease transport problems in the project's areas of influence, particularly in the rainy season when road surfaces deteriorate. The project will reduce road user costs sharply, contribute to the increase of agricultural production, and thereby help to improve rural income in the project areas. The highway component has an economic internal rate of return of 21 percent.

Date approved: March 30, 1976 (ADB)

POWER: The project consists of Phase I of the Fourth Power Distribution System Improvement and Expansion Program (FY 1977–FY 1981) of the Metropolitan Electricity Authority (MEA) and includes those sub-projects to be completed in FY 1977 and FY 1978 as follows: (i) *Substations*—construction, expansion, and modification to distribution substations. (ii) *Subtransmission lines*—installation of underground cables and installation of overhead lines. (iii) *Distribution*—installation of 670 kilometers of 24/12-kV overhead distribution lines and 45 kilometers of underground distribution cables and 1,420 kilometers of low voltage lines; installation of distribution transformers of various sizes (with a total capacity of 500 MVA); metering equipment; and procurement of maintenance equipment including line construction vehicles and tools.

THAILAND—Continued

Borrower: Metropolitan Electricity Authority (MEA).

Loan: $37.0 million (Ordinary Capital); 20 years, including a grace period of four years, interest rate 8.75 percent per annum. Total project cost $80.0 million.

Purpose and Benefits: The general objectives of the project are: (i) to expand the capacity of the existing distribution system; (ii) to increase the reliability of the system; and (iii) to extend the service area to the more heavily populated suburban and rural areas around Bangkok outside the metropolitan area. The substations will increase the number of energy transfer points from the Electricity Generating Authority of Thailand (EGAT) to the MEA system and the subtransmission lines will link the substations together; both will increase system capacity and improve system reliability. The new and expanded distribution substations will reinforce the supply facilities in the existing service area and together with the distribution lines will provide for extensions into areas not now supplied. MEA's Fourth Plan program envisages to increase its electrified area to about 80 percent and its overall coverage from about 70 percent of the total households at present to nearly 90 percent by the end of FY 1981. The project will meet the projected demand growth for the MEA system beyond 1978. It has an economic internal rate of return of about 12 percent and a financial internal rate of return of 9 percent.

Date approved: May 27, 1976 (ADB)

AGRICULTURE: The project consists of the development and extension of three existing land settlements, one each in the provinces of Satun, Yala, and Narathiwat in the southern region of Thailand. The principal components of the project are: (i) development and planting of rubber trees on about 16,000 ha; (ii) construction and improvement of about 330 km of rural roads and provision of equipment and a central workshop for road maintenance; (iii) settlement of 3,000 new families in 45 new villages, including housing, schools, clinics, and other facilities in 14 new village service centers; (iv) consultancy services for assistance in project management and coordination, rubber development, civil engineering works and credit and financial operations; and (v) training of settlement staff and settlers and studies on domestic water supplies, processing and marketing of rubber and further development of the settlements.

Borrower: The Kingdom of Thailand, Department of Public Welfare (DPW), the Ministry of Interior.

Loan: $16.1 million (Ordinary Capital); 30 years at 8¾ percent per annum. Total cost $38.9 million.

Purpose and Benefits: The principal purpose of the project is to accelerate the development of the three land settlements in order to generate employment and increase income for 3,000 new settler families and about 5,800 existing settlers. The project will allow for an orderly and efficient allocation and development of the land and thereby arrest the influx of squatters into the area. In addition to contributing substantially to increased cash incomes for the new and existing settlers, the project will provide an expanded range of social services and facilities in order to upgrade the living conditions of the new settlers. Benefits to the economy resulting from the project will be substantial, including the production of rubber for export valued at about $10 million annually, once rubber trees planted under the project reach maturity. It is estimated that the financial rate of return to a new settler is 18.6 percent, yielding his family an average net cash income of about $800 annually compared to average farm family incomes in Thailand of about $300 annually. The economic internal rate of return for the project is estimated at 12.3 percent. In addition, the project will have a substantial impact on income distribution patterns. The principal project beneficiaries will be people from the poorest segment of Thai society. About 8,800 farm families (about 45,000 people) will receive direct and sizable benefits as a result of the project in the form of substantially increased incomes and improved social services. Of this number, 3,000 new settler families will acquire new houses, better social services and the opportunity to become land owners. About 9,000 permanent jobs will be created in project activities among settler families alone, at an investment cost of about $3,300 per job. The majority of these people are Thai Muslims who are landless farm laborers, tenant farmers or rubber tappers from Thailand's poorest southern provinces of Yala, Narathiwat, Pattani and Satun.

Date approved: May 27, 1976 (ADB)

WESTERN SAMOA

POWER: The loan will supplement a previous Bank loan to Western Samoa for a power project, authorized June 19, 1973 for $2.3 million. The supplement will finance part of the foreign exchange funding of a cost overrun.

Borrower: Independent State of Western Samoa.

Loan: $1.4 million (Special Funds); 40 years (includcluding a 10-year grace period) with a 1 percent service charge per annum. Change in total project cost: From $2.7 million equivalent to $4.5 million equivalent.

Purpose and Benefits: The project's objective is to provide reliable and adequate electric power to the Apia area and to the more densely populated areas of the two main islands of Upolu and Savai'i. As originally envisaged, the project was to be completed by 1976 with total installed capacity of 3,600 kW and expected to meet the service area's requirements up to 1980. Since the earlier approval of the project in 1973, electric power requirements including costs and other factors have changed significantly, thus necessitating revision of the project scope and implementation schedule. Under the revised project, installed capacity will be 3,420 kW with completion scheduled by mid-1978. There will be no change from the original project scope for the island of Upolu. In the island of Savai'i, however, three diesel generating units, each with capacity of 100 kW, will be installed, in contrast to the original plan for two units of 300 kW each. For the Asau port area on the same island, more recent projections indicate electric power requirements to be 60 kW by 1980 and 100 kW by 1985. The installation of two 60 kW generating sets will be in lieu of the original scheme to relocate two sets of 220 kW each from Apia to Asau. No substantial changes from the original proposal have been made with respect to installation of transmission and distribution lines, procurement of vehicles, communications equipment and imported materials, and consulting services. The expected social and economic benefits will not be affected adversely by the reformulation or the cost overrun. However, the financial viability of the managing agency might be impaired by servicing the additional debt resulting from the supplementary loan. In order to avoid this, the Government has authorized an overall increase of 10 percent in the rates charged consumers, effective as of April 1, 1976, which should be adequate. The revised project has a financial rate of return estimated to be 10.4 percent.

Date approved: December 18, 1975 (ADB)

STATISTICAL APPENDIX

SECTION A.—U.S. Balance of Payments

TABLE A-1.—*U.S. balance of payments, fiscal years 1975–76*

[Millions of dollars]

	Fiscal 1975	Fiscal 1976	Fiscal 1976 (Seasonally Adjusted) 1st half	Fiscal 1976 (Seasonally Adjusted) 2d half
Current Account Transactions:				
Merchandise trade, balance of payments basis,[1] net	1,276	1,308	4,292	–2,984
Exports	104,360	109,728	54,330	55,398
Imports	–103,084	–108,420	–50,038	–58,382
Military transactions, excl. grants, net	–1,720	–107	–96	–11
Deliveries under sales contracts	3,366	4,408	2,182	2,226
Expenditures	–5,086	–4,515	–2,278	–2,237
Travel, excl. transocean fares, net	–1,645	–1,448	–804	–644
Receipts	4,448	5,247	2,536	2,711
Payments	–6,093	–6,695	–3,340	–3,355
Other services, excl. investment income, net	3,238	3,722	1,890	1,832
Receipts	13,824	15,004	7,356	7,648
Payments	–10,586	–11,282	–5,466	–5,816
Investment income, net	7,597	7,724	3,323	4,401
Receipts on U.S. assets abroad	22,366	20,258	9,338	10,920
Payments on foreign assets in the U.S.	–14,769	–12,534	–6,015	–6,519
Private remittances and government transfers other than grants	–1,753	–1,786	–862	–924
Government economic grants	–2,939	–2,499	–1,433	–1,066
Balance on current account transactions	4,054	6,914	6,310	604
Capital Account Transactions:				
U.S. assets abroad, net (acquisitions (–) /liquidations (+))	–31,405	–34,558	–15,648	–18,910
U.S. official reserve assets	–1,220	–2,604	–253	–2,351
Other U.S. Government assets	–3,029	–3,438	–1,723	–1,715
U.S. private assets	–27,156	–28,516	–13,672	–14,844
Direct investments	–8,975	–3,758	–2,464	–1,294
Foreign securities	–3,888	–7,272	–3,299	–3,973
Other assets reported by U.S. nonbanking concerns	–98	–3,274	–1,944	–1,330
Other claims reported by U.S. banks	–14,195	–14,212	–5,965	–8,247
Foreign assets in the U.S., net (acquisitions (+) /liquidation (–))	22,222	21,135	8,581	12,554
Foreign official assets[2]	13,138	9,067	1,165	7,902
Industrial countries	2,312	–3,335	–2,683	–652
OPEC members	10,037	11,228	4,395	6,833
Other countries	789	1,174	–547	1,721
Other foreign assets	9,084	12,068	7,416	4,652

See footnotes at end of table.

TABLE A–1.—*U.S. balance of payments, fiscal years 1975–76*—Continued

[Millions of dollars]

	Fiscal 1975	Fiscal 1976	Fiscal 1976 (Seasonally Adjusted)	
			1st half	2d half
Direct investments	980	1,000	1,181	−181
U.S. Treasury securities	1,130	2,205	2,338	−133
Other U.S. securities	31	2,936	1,776	1,160
Other liabilities reported by U.S. nonbanking concerns	1,251	−664	−209	−455
Other liabilities reported by U.S. banks	5,692	6,591	2,330	4,261
Balance on capital account transactions	−9,183	−13,423	−7,067	−6,356
Statistical discrepancy	5,129	6,509	757	5,752

[1] The figures for merchandise trade included in balance of payments compilations are based on data collected by the Bureau of the Census, but are adjusted for coverage and timing. The balance of payments figures also exclude exports and imports by U.S. defense agencies which are included in military transactions. Details of the adjustments are shown in table 3 of the quarterly balance of payments compilations published in the "Survey of Current Business".

[2] Including claims representing prepayments on military and other U.S. Government sales contracts.

Source: "Survey of Current Business" June and September 1976 published by U.S. Department of Commerce, Bureau of Economic Analysis.

SECTION B.—Statistical Tables on U.S. Government Foreign Grants, Credits, and Other Assistance

Explanatory Note

The statistical tables, and this Explanatory Note, were prepared by the Bureau of Economic Analysis, Department of Commerce, in consultation with the National Advisory Council Secretariat, in accordance with specifications of the National Advisory Council. This presentation continues that formerly published in more detail by the Bureau of Economic Analysis, in "Foreign Aid by the United States Government, 1940–1951," a 1952 supplement to the *Survey of Current Business,* and in the periodic report *Foreign Grants and Credits by the United States Government.*

The tables are compiled by the Bureau of Economic Analysis from information made available by agencies operating the grant, credit, and other assistance programs, and include some estimates for transactions not yet recorded on the operating agencies' books.

Items which are based on estimates have been adjusted or qualified on the basis of information received to the date of preparation of these tables, but in some instances are subject to future adjustments.

The data on credits included in this *Report* are comparable, with minor exceptions, to those appearing in *Foreign Credits by the United States Government,* a semiannual publication of the Department of the Treasury, in which a detailed enumeration of every active foreign credit of the U.S. Government, showing its current status, is presented.

Transactions included.—The data tabulated in this appendix are divided into three categories—grants, credits, and other assistance through net accumulation of foreign currency claims under programs for the sale of agricultural commodities. The Government's capital investments in, or contributions to, the international financial institutions constitute an additional measure taken by this Government to promote foreign economic recovery and development.

Payments to the *international financial institutions* do not result in immediate equivalent aid to foreign countries. Use of available dollar funds is largely determined by the managements of the institutions, in some instances subject to certain controls which can be exercised by the U.S. Government. Changes in the procedures for disbursing the U.S. Government contributions, initiated in 1965, have retarded such actual Government payments to agree more closely with the actual disbursement of assistance by the international institution to the foreign country.

Grants are transfers for which no payment is expected,[1] or which at most involve an obligation on the part of the receiver to extend aid to the United States or other countries to achieve a common objective. *Credits* are loan disbursements or transfers under other agreements which give rise to specific obligations to repay, over a period of years, usually with interest. *Other assistance* represents the transfer of U.S. farm products in exchange for foreign currencies (*plus*—since the enactment of Public Law 87–128—principal and interest collections in foreign currencies for credits extended under the farm products sales program) *less* the Government's disbursements of the currencies as grants, credits, or for purchases. The net acquisition of currencies represents net transfers of resources to foreign countries under the agricultural programs, in addition to those classified as grants or credits. Detailed descriptions of the types of transactions included in these categories are given in the Explanatory Note to the statistical appendix of the *Report* of the National Advisory Council for January–June 1960.[2] Additions to and changes in these descriptions are given below.

A distinction is made in these tables between *military grants* and *other grants.* Generally, this classification is made from the underlying legislative authorization under which the assistance is provided, classifying as military those programs that were enacted to furnish military supplies or services to foreign countries. In addition to obvious delivery of military supplies and concomitant services, cash payments to provide for the purchase of such military-end items are also included as military grants. On the other hand, aid provided as "defense support" or "security supporting assistance"—even when intended to provide support to a beneficiary in its budget maintenance of its military force—is included in the *other grants* category. No distinction is made between military and other credits.

Occasionally, assistance has been given under indeterminate conditions, subject to future settlement. Indeterminate aid on this basis is included with grants, in the period rendered. When settlement for such indeterminate aid is agreed upon, the terms may call for a cash settlement or may establish a long-term credit. Cash settlements are included in returned grants. Amounts of the newly established credits are added to outstanding indebtedness.

The term *assistance* is applied as a concise label to the aggregation of transactions reported on in this section. Most of these transactions were authorized under legislation specifically intended to provide foreign *aid,* or foreign *assistance,* through grants or long-term credits with low interest rates. However, other transactions were authorized under legislation intended to promote export trade by providing credit support to foreign economies on relatively hard, commercial, *nonconcessional* terms. One significant "commercial" program is that of the Commodity Credit Corporation.

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[1] In many instances, a limited percentage of the counterpart funds (the commensurate foreign currency value), or of the foreign currency proceeds resulting from the distribution of goods through commercial channels in the foreign country, is required to be made available to the U.S. Government.

[2] H. Doc. No. 154, 87th Cong., 1st sess.

The U.S. Government receives some returns on its gross grants and credits. The returns which are deducted from gross grants and credits to arrive at net grants and credits include (1) reverse lend-lease; (2) the dollar value of the portion of grant counterpart funds paid to the United States for its use; (3) returned lend-lease and civilian supply ships; (4) returns of military equipment "loaned"; (5) cash received in war-account settlements for lend-lease and other aid; and (6) principal repaid on credits, but not interest. The Government's disbursements of currencies are deducted from the accumulation of currency claims in calculating net other assistance.

Interest collected on the credits extended by the U.S. Government is tabulated separately in this *Report*. The data on interest shown in this *Report* do *not* include the interest collected on accumulated foreign currencies on deposit abroad.

Tables B-1 through B-5, B-6, and B-12 emphasize the net amounts of grants, credits, and other assistance. Gross grants, gross credits, and deliveries under farm products sales are shown separately in *Tables B-1, B-2, B-5A, and B-12* for the convenience of those who desire to measure the utilization of the legislative authorizations for aid.

Repayments of principal and interest collections are also shown in *Tables B-1, B-5B, B-10, and B-11*. Over short periods of time, such as 1 year, the total of gross grants, gross credits, and *net* other assistance is an effective statistical tool, but for longer periods the addition of the three categories introduces further conceptual difficulties, particularly where revolving authorizations (such as for Export-Import Bank loans) are involved.

Comparable data: Balance of payments.—The total amount for Government capital contributions to international financial organizations, grants, credits, and other assistance in this section is not identical with the amount shown for Government grants and capital in the balance-of-payments accounts in *Table A-1* of this *Report*. The main factors contributing to this difference are: (1) Contributions to the multilateral-construction program of the North Atlantic Treaty Organization are included as military grants in this section, but are shown only as military expenditures in the balance of payments, and (2) Government investments in certain productive facilities abroad, Government receipts on funded claims, and net changes in foreign currency holdings resulting from transactions other than those under the farm products programs are included in U.S. Government capital in the balance-of-payments statements but not in this section (see *Exclusions*, below). The balance-of-payments statistics on U.S. Government capital movements also include changes in other short-term assets—accounts receivable and short-term credits up to and including 1 year—which are excluded from data in this section.

There is some difference in classification of transactions which are incorporated into both the balance-of-payments statistics and in this section. *Grants financing military purchases* (including expenditures to release Israel from its contractual liability to pay for defense articles and services purchased through military sales contracts) are not included in military unilateral transfers, but in other unilateral transfers, in the balance-of-payments account; such expenditures are included in *military grants* in this section.

Entries in balance-of-payments accounts for interest collected by the U.S. Government include, in addition to the data reported in *Table B-11*, income on Government investment in certain productive facilities abroad, on foreign currency and U.S. dollar balances held in foreign depositaries, and on the U.S. Government holdings of special drawing rights (the latter being recorded net of payments on charges on the allocation of special drawing rights).

Comparable data: International investment position.—The total amount for outstanding indebtedness of foreign countries on U.S. Government credits shown in this section is not identical with the entry for nonliquid assets of the U.S. Government in articles entitled "International Investment Position of the United States" that are published annually by the Bureau of Economic Analysis in its *Survey of Current Business*. "Long-term credits" in the annual article includes—in addition to the data from *Table B-8* of this *Report* and the accumulation of the Government capital contributions to international financial organizations (from *Table B-1*)—the cumulative asset position of certain funded claims and Government investments in productive facilities abroad.

Dollar equivalents.—The measure of foreign grants and credits generally is in terms of (1) dollars disbursed by the U.S. Government to or for the account of a foreign government or other foreign entity or individual, (2) dollar equivalents of goods delivered or shipped, services rendered, or foreign currencies disbursed to or for such foreign account, and (3) the dollar equivalent of interest capitalized and of outstanding principal that is refinanced. Correspondingly, returns are measured in terms of the dollars received by the U.S. Government, or the dollar equivalents of goods, services, and foreign currencies received. Dollar equivalents are, of necessity, frequently estimated.

Equivalents on credits.—Utilizations and collections of principal and interest include those in U.S. dollars, other currencies, materials, and services. The medium of exchange of one transaction on a credit (such as utilization by disbursement) does not determine the medium of exchange of another (such as interest collections). Because of the variety of these media of exchange, meaningful interprogram, intraprogram, and intercountry comparability of the data is achieved through the use of dollar equivalents for all transactions not in U.S. dollars, statistically calculated upon procedures outlined in applicable Office of Management and Budget and Treasury Department regulations.

To reflect the significant part of the foreign indebtedness to the U.S. Government on credits that is repayable in foreign currencies, two supplemental tables (*B-8A and B-8B*) are included in this *Report*. They separate the total outstanding indebtedness amounts shown in *Table B-8* into the two categories "Repayable in U.S. dollars" (at the option of the U.S. Government) or "Repayable in foreign currencies" (at the option of the debtor).

Fiscal data.—The measure of grants and credits shown here—transfers—is not fiscal data. It is the same as *budget expenditures* only when dollars are disbursed as direct assistance. Expenditures in payment of the goods or services often occur before or after the actual transfers recorded here. The amounts of transfers are sometimes estimated from data on expenditures or (for services rendered) from fiscal data on *obligations.* Values of commodities transferred from Commodity Credit Corporation (CCC) stocks are frequently estimated at current export offering price, *not* at CCC cost (see paragraph 5 in the section *Grant, credit, and other transactions covered,* below).

Periods covered.—Revised summary data for the entire postwar period (July 1, 1945,[3] through December 31, 1975) are included in *Table B–1. Tables B–2 through B–6 and B–11* present data for the first 24½ postwar years, July 1, 1945, through December 31, 1969, in total, and annually for each subsequent calendar year. Revised data on credit activity for the entire postwar period are given in *Tables B–7 and B–10. Table B–12* presents data on other assistance (through the farm products sale programs) for the postwar period.

In preparing the section tables, data collected from reporting agencies have been adjusted in some instances to place in the proper period transactions which supplemental data have shown actually occurred other than in the period in which reported. However, such changes have generally been made only when the adjustments appeared sufficiently large to be significant.

Geographical presentation.—Assistance is shown by country, or general area, where possible. In certain instances (particularly in the earlier postwar period), data for parent countries include those for their dependent area; for example, although goods have been shipped to a then dependent area, Tunisia, such aid was reported as rendered to the parent country, France. Data for Japan include transactions for the Ryukyu Islands, shown separately in *Reports* prior to the agreement with Japan concerning reversion of the Ryukyu Islands that entered into force May 15, 1972.

Transactions shown for a country are *not* necessarily with the government of such country, but are often with individuals, relief organizations, multinational organizations, or other private entities located in the designated country and considered to be within its economy. Thus, for example, net credits for Canada include loans to Canadian Pacific, Ltd., and the net grants for Hungary include relief commodities donated to the League of Red Cross Societies for distribution to individuals.

The area *Western Hemisphere,* for which totals are shown in all geographical tables, excludes Canada; and data for Canada are always shown separately.

Because most data for the major military aid programs were available for publication only in the groupings established by the Mutual Security Act of 1954, Public Law 83–665, as amended, country detail is generally not shown for any military grants except in *Table B–1.* These data are included in the respective geographical areas except that military grant aid to Near East (including Greece and Turkey) and South Asia is included in *Western Europe* and military grant aid to New Zealand is included in *Asia* in *Tables B–3 and B–4.* The military aid for which data are not available by area is shown as *Unspecified, all areas.*

Data specially compiled and released by the Defense Department have been used in compiling *Table B–1,* as indicated in footnote 3 thereto. These data are not exactly equivalent to the amounts reported by the Defense Department for inclusion by geographical area in these tables. Where country data were not available, the data are included by area as indicated in the preceding paragraph. *Tables B–3 and B–4* include detail for military grants only for the areas, as indicated in the preceding paragraph.

Where country detail is not available the data are shown if possible by area as *Unspecified,* for a named area, otherwise as *Unspecified, all areas.*

Transactions excluded.—In addition to the U.S. Government grant programs included in this section, there are several operations of the Government abroad which are sometimes called grants or assistance, but are not included in these tables. Details of, and elaboration on, many of these grant exclusions are given on pages 37–38 of the *Report* for January–June 1960.[2] Some changes in exclusions since the earlier *Report* are set out in the section *Grant, credit, and other transactions covered,* below.

Several types of transactions represent value received *by* the U.S. Government but are not included in the returns data. No cognizance of advances to the U.S. Government has been taken in the derivation of net credits.

Transactions on "World War I indebtedness," including those arising from disbursements under the Liberty Bond Acts in 1929, are excluded from the tables in this section.

The U.S. Government frequently settles claims on its behalf for financial consequences of the actions of another government (such as in the agreement with France entered into June 12, 1975), or settles claims espoused on behalf of U.S. nationals for property, rights, and interest affected by nationalization or expropriation (such as in the agreement with Hungary entered into March 6, 1973). Although the U.S. Government often receives single settlement collections or agrees to accept deferred collection on what becomes *funded claims,* the transactions are excluded from the tables in this section.

Transactions involving relatively *short-term* foreign indebtedness to the U.S. Government are excluded from the tables, among which are the following significant categories.

1. Some transactions under the Commodity Credit Corporation export credit sales program, such as those reported in *Table M–3* of the statistical appendix, are excluded from the tables in this section, to the extent they represent receivables originally scheduled to mature in 1 year or less. The *Annual Report of Financial Condition and Operations* of the Commodity Credit Corporation shows "Accounts and Notes Receivable, due from foreign importers under export credit sales program." The Corporation has reported this amount, as of December 31, 1975, at $776 million, of which $107 million represented receivables originally scheduled to mature in 1 year or less. The export credit sales program claims scheduled to mature in periods in excess of 1 year are included in the data in this *Report* (see paragraph 16 in the section *Grant, credit, and other transactions covered,* below).

2. Short-term credits and other receivables originally scheduled to mature in 1 year or less and extended under the provisions of the Foreign Military Sales Act (sections 21 and 22) are excluded from the tables in this section.

[3] For lend-lease, surplus property, and grant settlements, the postwar period is calculated from V–J Day (Sept. 2, 1945).

[2] H. Doc. No. 154, 87th Cong., 1st sess.

3. Transactions of the U.S. Exchange Stabilization Fund under exchange agreements are also excluded from the tables in this section.

4. Accounts receivable on international postal accounts, pending settlement by offset or collection, and accounts receivable from other governments for their shares of operations of the international ice patrol under the International Convention for the Safety of Life at Sea (Treaties and Other International Acts Series 3597) are excluded from this section.

Transactions with international financial institutions covered.—The U.S. Government has made equity capital investments in international financial institutions which provide development and other longer term economic assistance to foreign countries.

Payments of the U.S. quota in the International Monetary Fund are the primary basis for calculating the net asset position of the United States in the Fund. Such asset is considered to be a monetary reserve asset held with the Fund and, thus, the U.S. investments in the Fund are *not* included in the figures in this section. The Fund provides general financial assistance of relatively short term to all of its members, and the United States itself drew from the Fund in 1964–67; all these drawings were settled by the end of 1968. The United States again drew from the Fund in 1970–72; all of these drawings were settled by March 1975.

No attempt has been made in these tables to allocate to foreign countries the assistance rendered through these international financial organizations by use of U.S. Government investments. The U.S. Government has a larger equity investment in the paid-in capital of these institutions than any other government. Data on the operations of these international institutions are included in sections D through I of the statistical appendix.

Specifically the international financial institution investments that are included in this section of the appendix are those in the three international financial institutions in the World Bank Group—the Bank itself, and the International Development Association (IDA) and the International Finance Corporation (IFC)—and two regional institutions—the Asian Development Bank (ADB) and the Inter-American Development Bank (IDB)—as described in the following paragraphs. Technical assistance grants that have been made to these institutions are recorded in the category *Grants* and not in the figures on equity investment.

1. U.S. participation in the World Bank, the *International Bank for Reconstruction and Development* (IBRD), was authorized in Public Law 79–171 (the Bretton Woods Agreements Act). The authorized capital subscription was increased to $6,596 million by Public Law 91–599. The Congress appropriated $6,473 million to purchase these subscriptions.[4]

IBRD borrows much of the funds it lends by floating bond issues. The bulk of the Government subscription constitutes a guarantee of these bonds, and is callable by the IBRD to meet its obligations in the remote possibility of a drastic deterioration of the ability of the Bank's debtors to repay their borrowings. Of the total Government subscription, only 10 percent is paid-in capital to be used for operations, and the remainder may be called only to meet IBRD obligations on securities it has issued or guarantees it has given. The Bank lends only to member governments or on loans guaranteed by member governments, central banks, or comparable agencies of the member government.

2. Public Law 86–565 authorized an initial U.S. subscription of $320 million to the *International Development Association;* the purpose of IDA is to promote the economic development of less-developed member countries whose needs cannot be met under IBRD lending programs. Subsequent legislation in Public Laws 88–310, 90–14, 92–247, and 93–373 authorized increased U.S. participation in the resources of IDA, bringing the allowable U.S. contributions to $3,572 million.[4]

3. *The International Finance Corporation* was created to supplement the activities of IBRD by making direct loans to private enterprises without government guarantees as to repayment. The U.S. subscription of $35,168,000 was authorized by Public Law 84–350.

4. Public Law 89–369 authorized an initial U.S. subscription of $200 million ($100 million paid-in capital and the remainder callable capital) to the *Asian Development Bank;* the purpose of ADB is to foster economic growth and cooperation among countries in Asia and the Far East, collectively and individually. In 1972, $100 mililon was authorized for a contribution of "United States Special Resources" in Public Law 92–245.[4]

Public Law 93–537 increased the authorized U.S. subscription by $362 million ($72 million paid-in capital and $290 million callable capital) and the contribution to special funds by $50 million. The $150 million special funds resources have been subscribed to the Asian Development Fund.

5. Public Law 86–147 authorized an initial U.S. subscription of $150 million to the paid-in capital, of $200 million to the callable capital, and of $100 million to the Fund for Special Operations of the *Inter-American Development Bank.* The Bank is authorized to issue securities, and the Government subscription is callable to guarantee such securities. Through 1975, Public Laws 88–259, 89–6, 90–88, 91–599, and 92–246 successively raised the authorized subscription to the Fund for Special Operations to $2,800 million. Public Laws 88–259, 90–325, and 91–599 have raised the authorizations for callable capital to over $1,697 million. Public Law 91–599 raised the authorization for paid-in capital to $300 million.[4]

Grant, credit, and other transactions covered.—Detailed descriptions of the types of transactions included in these categories are given on pages 39–50 of the *Report* for January–June 1960.[2] The following changes in coverage in the present section should be noted.

[4] Public Law 92–268, the Par Value Modification Act (as amended by Public Law 93–110), also authorized additional payments "to maintain the value in terms of gold of the U.S. dollar holdings" to the extent provided in the Articles of Agreement of the IBRD, IDA, ADB, and IDB.

[2] H. Doc. No. 154, 87th Cong., 1st sess.

1. Revisions in security classifications have enabled the inclusion of data for one credit and two grant programs in this section, although these programs were noted as excluded in the *Report* for January–June 1960.[2] These programs are *Philippine military aid* provided under Public Law 79–454; *Japanese military aid* enacted in section 108 of Public Law 83–665; and credits for *financing of military sales* under subsections 103 (c) with maturities up to 10 years and 106 (b) with maturities up to 3 years, of Public Law 83–665, as amended, and as superseded by the provisions of subsection 503(a) and of section 522 of Public Law 87–195, as amended, and as superseded by Public Law 90–629. The revised data for these programs are separately shown in *Table B–2* and are incorporated into the other tables, in their proper categories.

Data for military grant deliveries to Southeast Asia, funded by direct Defense Department appropriations—instead of under the Foreign Assistance Act—after enactment of Public Law 89–367, have become available for inclusion in these tables, and are described below in paragraph 4.

2. The presentation of data on operations of the *Export-Import Bank* has been revised from that used in the *Report* for January–June 1960[2] in respect to advances by others when guaranteed by the Export-Import Bank. These are now *excluded from* the data on disbursements and principal repayments, whereas in the January–June 1960 *Report* they were included.

Export-Import Bank loan disbursements are reported after deducting some transactions classed by the Bank as "reimbursements by participants." Such reimbursements represent recovery of U.S. Government funds (1) through sales to private U.S. participants of fractions of notes acquired previously for the Export-Import Bank's portfolio or (2) where the Bank acts as an agent for the participating private domestic or foreign entity, or a foreign government, in current disbursements of a loan. However, reimbursements through sales to *foreign* participants, either in the country of the borrower or a third country are not included in "reimbursements by participants," but are included in "principal collections," in this presentation. A participation of other Government agencies (*except* for one transaction involving $7 million and participations in individual loans sold to the Secretary of the Treasury deposit accounts related to foreign government defense procurement in the United States, aggregating $312 million) in loans of the Export-Import Bank is generally not included in disbursements of the Bank in this presentation, but is included against the other program only.

Many recent Export-Import Bank loans have been extended to cooperative financing facilities, banks which in turn lend to their customers for purchases from the United States. Loans extended by Export-Import Bank to foreign banks are geographically classified in this *Report* against the country of the borrowing foreign bank (including foreign branches of U.S. banks) and are not recorded against the importing country; such loans directly to U.S. parent banks or U.S. branches of foreign banks, in the amount of $14 million outstanding, have been excluded from these data.

[2] H. Doc. No. 154; 87th Cong., 1st sess.

The sale of Eximbank Investment Portfolio Participation Certificates (which afford the purchasers a stipulated return at a fixed rate of interest) is not recorded in these data, even though sold to foreign purchasers.

3. *Foreign Assistance Act and related programs* are those authorized by the Foreign Assistance Act of 1961 (Public Law 87–195), in particular under parts I and II, as amended. The programs are the successors to the mutual security programs described on pages 40–41, 41–43, and 46–47 of the *Report* for January–June 1960.[2]

Public Law 87–195 repealed the (corporate) Development Loan Fund. Loans of this Fund are included under *Foreign Assistance Act and related programs* in *country program loans*. The Agency for International Development (AID) is the successor to the International Cooperation Administration and the (corporate) Development Loan Fund in operating the programs described on pages 41–50 of the *Report* for January–June 1960.[2]

Loans and grants for Latin American development and Chilean earthquake reconstruction assistance under Public Laws 86–735 and 87–41 are included in *Foreign Assistance Act and related programs*. These include the operations of the *Social Progress Trust Fund*, administered by the Inter-American Development Bank on behalf of the United States, which are separately set forth.

Loans of the Overseas Private Investment Corporation (OPIC), created under Title IV of Public Law 87–195, as amended, together with foreign credits extended in disposition of assets acquired by OPIC under its *investment incentive* programs, are also set forth. In the same entries are included assets sold or guaranteed by OPIC that have been purchased by the Federal Financing Bank, described below in paragraph 18.

The U.S. contribution to the capital of the European Payments Union (EPU), to which this Government did not belong, was recorded as a grant in 1950–51 under the European recovery program (one of the predecessor programs to the Foreign Assistance Act). The residual assets of the EPU continued to be available to the European Fund when the European Monetary Agreement entered into force in 1958. Upon liquidation of the European Fund in December 1972, the U.S. Government received that part of the Fund which had originated in the U.S. contribution to the founding of the EPU and the income earned on this capital during the lifetime of the Fund. Of the $232 million recovered by the U.S. Government, $114 million was in the form of assignment to the U.S. Government in 1972 of a credit that had been extended to Turkey by the European Fund; $118 million was paid the U.S. Government in U.S. dollars early in 1973. The 1972 recovery is recorded in the data in this section as a reverse grant under the *Foreign Assistance Act and related programs*, offset by a credit extended to Turkey under *Other credits* described in paragraph 17.

4. *Military aid* under the *Foreign Assistance Act and related programs* includes the transactions under the predecessor mutual security programs described on pages 40–41 of the *Report* for January–June 1960.[2]

Military assistance, service funded includes Defense Department estimates of the dollar value of assistance provided under congressional authorization in Public Law 89–367 for "support of Vietnamese and other free world forces in Vietnam . . . on such terms and conditions as the Secretary of Defense may determine." Pursuant to this authorization, funding for such transfers was established under direct Defense Department appropriations instead of from the military assistance programs under the Foreign Assistance Act. *Military assistance, service funded* also includes estimates of the acquisition cost of supplies and equipment which were excess to the needs of the U.S. Armed Forces and transferred to the countries receiving military assistance funded from Defense Department appropriations.

Estimates of the value of transfers funded by Defense Department appropriations are based upon the reports compiled by the Defense Department pursuant to Public Law 89–367 (subsection 401 (b)), and on supplemental substitute information provided by the Defense Department. Fiscal year estimates of the value of excess supplies and equipment, provided by the Defense Department, have been smoothed into quarterly series and summed into calendar year totals by the Bureau of Economic Analysis.

The Defense Department has indicated that because of combat conditions in Southeast Asia, the reporting system for the support furnished to foreign forces from Defense Department appropriations provided only for recording of data recognizing formal accounting obligation of the appropriation, when available, or the recording of estimates where precise obligation data could not be maintained. The Defense Department in 1974 provided supplemental information requiring appreciable revision of these estimates. It is still endeavoring to provide supporting detail for some of the resulting estimates that have been furnished for use in these statistics. As these data are further analyzed and as additional details become available, further revisions may be made in these presentations. Indications are that these estimated amounts of transfers for the support of foreign forces include services and construction costs as well as supplies and equipment.

Section 3 of Public Law 91–652 authorized the President to transfer to the Republic of Korea defense articles located in Korea and belonging to the Armed Forces of the United States on July 1, 1970. The estimated original acquisition cost of such equipment reported by the Defense Department is included in *Korean military aid.*

Multilateral construction program contributions originally authorized under section 104 of Public Law 83–665, as amended, continues under the authority of section 503 (clause (b)) of Public Law 87–195, as amended. Recent appropriations in support of the authorization were made directly to the Defense Department.

Transactions under the Emergency Security Assistance Act of 1973 (Public Law 93–199) are included in these data: There were extraordinary deliveries of material to Israel, associated with the Middle East war that began in October 1973. This equipment was ordered by Israel from the U.S. military services under the Foreign Military Sales Act (Public Law 90–629), utilizing the provisions for short-term credit for payment within 120 days of delivery. Under Public Law 93–199, the President determined in 1974 that $1½ billion of the funds authorized would be used to release Israel from its contractual liabilities to pay for the defense articles and services purchased under the Foreign Military Sales Act. These transactions are recorded as *Grants financing military purchases* when expenditures are made against the appropriation (Public Law 93–240). Additional similar releases from contractual liability authorized under subsequent legislation (Public Law 93–599 (subsection 45 (a) (7 (B)) and Public Law 94–329 (subsection 210(c) (1)) are also included. Repayable long-term credits extended under Public Law 93–199 and the subsequent legislation are *not* included in this entry.

Credits financing military purchases under Public Law 87–195 and under the earlier mutual security programs described on page 47 of the *Report* for January–June 1960 [2] are included along with those under Public Law 90–629. This entry also includes long-term credits extended to Israel under section 501 of Public Law 91–441 and under section 3 of the Emergency Security Assistance Act (Public Law 93–199). Included in this entry are credits disbursed by the Federal Financing Bank (described below in paragraph 18), when such assets have been guaranteed by the Defense Department under provisions of Public Law 90–629.

5. Public Law 89–808 amended Title II of Public Law 83–480 consolidating into this one title the authorizations to extend grants by transfers of agricultural commodities *for famine, other urgent, and extraordinary relief, for economic development, and through private welfare agencies.* This authority continues the programs described on page 43 of the *Report* for January–June 1960.[2]

All transfers under these authorizations for calendar year 1966 and later are included in these data at values approximating a current export value rather than the price paid by the Agriculture Department in support of domestic commodity prices. Donations through private welfare agencies from July 1, 1954, through December 31, 1965, are also included at values approximating a current export value. Donations through private agencies transferred before fiscal year 1955, and transfers under famine and other urgent and extraordinary relief before calendar year 1966, are included in these data at Commodity Credit Corporation cost value.

6. Most *currency loans to foreign governments* under the *Agricultural Trade Development and Assistance Act* are those under the subsection which authorizes loans to promote multilateral trade and economic development, through established banking facilities of the nation where the foreign currency was obtained, or in any other manner which the President may deem to be appropriate. Some loans are under the subsection which authorizes use of the foreign currencies to procure equipment, materials, facilities, and services for the common defense including internal security. Under the subsection which authorizes use of the foreign currencies for financing the purchase of goods and services for other friendly nations, the currencies have been used to provide loans to third countries. In practice, most of the loans have been made to foreign governments or government-controlled banking institutions, but some have been made, under the authority given to the President, to private entities. These loans are administered by AID and utilization represents the dollar equivalent of foreign currencies disbursed, as reported by AID. Collections of principal and interest are in dollars and foreign currencies.

[2] H. Doc. No. 154, 87th Cong., 1st sess.

7. *Long-term dollar credits under the Agricultural Trade Development and Assistance Act* (providing long-term supply contracts repayable in dollars), includes those originally authorized by section 14 of Public Law 86-341 and by other, subsequent amendments to Public Law 83-480, in particular section 106, as amended by Public Law 89-808. Also included as dollar credits are those under subsection 103(b) under agreements which permit the U.S. Government at its option to elect, in lieu of dollar repayment, collections in readily convertible currencies of third countries. In addition to intergovernmental credits, those credits under section 107, to private trade entities are also included.

8. *International refugee assistance* includes assistance provided through international organizations, and through grants to voluntary agencies for work abroad, under the Migration and Refugee Assistance Act of 1962 (Public Law 87-510), as amended, and under the Indochina Migration and Refugee Assistance Act of 1975 (Public Law 94-23), as amended. Support of the International Committee of the Red Cross, a Swiss voluntary agency, authorized under Public Law 89-230, as amended, and assistance to Israel in the resettlement of refugees from the U.S.S.R., first authorized under Public Law 92-352, are also included.

9. Additional compensation for the unpaid balances of awards for war damage claims under Title I by the Philippine Rehabilitation Act of 1946 (Public Law 79-370) was authorized in Public Law 87-616 and is included in entries for *Philippine rehabilitation program.*

10. *Peace Corps program* includes the services rendered under Public Law 87-293, as amended, by Americans helping foreign countries meet their needs for trained manpower. This assistance is measured in terms of the expenditure of funds appropriated for expenses, allowances, services, and equipment of the Peace Corps volunteers and includes training and administrative costs of the program.

11. An agreement with Japan for settlement of postwar economic assistance was signed January 9, 1962, and entered into force September 11, 1962. An agreement with Japan concerning reversion of the Ryukyu Islands was signed June 17, 1971, and entered into force May 15, 1972.

On October 18, 1972, an agreement regarding settlement of lend-lease, reciprocal aid, and claims was signed with the Soviet Union.

As these agreements reflect conversions—into repayable principal credits—of amounts previously reported as grants, no utilization of credits is reported in the accompanying tables, but principal and interest collections, where applicable, are included in the respective data for *lend-lease, surplus property,* and *settlements for grants and war accounts,* in the manner similar to other settlements described on page 48 of the *Report* for January–June 1960.[2]

12. Returns under the *civilian supply program* include proceeds from the sale of stock of the Bank of the Ryukyus in 1972. This investment in the Bank was an asset of the general fund of the U.S. Civil Administration of the Ryukyu Islands, which had been funded from the civilian supply (government and relief in occupied areas) program.

13. *Other reverse grants and returns* includes the contribution from Japan which—under the agreement of April 18, 1969, and Public Law 92-39—will be combined with an equivalent amount of U.S. Government funds and disbursed for the welfare of the people of the Trust Territory of the Pacific Islands.

14. *Surplus property credits* includes, beginning in 1973, credits arising from sale of Government-owned land and structures, now excess for Foreign Service needs, on the basis of deferred collections.

15. *Other credits* includes credits by the Atomic Energy Commission under the *Atomic Energy Act,* Public Law 83-703, as amended, wherein the Atomic Energy Commission is authorized to sell material to any country with which an agreement for cooperation has been signed, and under the EURATOM Cooperation Act of 1958 (Public Law 84-846, as amended), which authorized the sale on (first lien) credit terms of material to the European Atomic Energy Community.

16. *Other credits* includes the credits extended under the authority of the *Commodity Credit Corporation Charter Act* through the Corporation's export credit sales program GSM-4, whereby beginning April 27, 1967, it purchased foreign receivables from U.S. exporters. Data on receivables with original maturities in excess of 12 months from date of delivery are incorporated into the tables in this *Report;* data on the receivables purchased by CCC under program GSM-4 but originally representing financing periods of 12 months or less, amounting to $107 million outstanding as of December 31, 1975, are *not* included in these data. Transactions under the earlier CCC export credit sales programs were excluded from the table in this section since they did not represent obligations of a foreign debtor to the U.S. Government. Under settlement arrangements with the Arab Republic of Egypt consolidating past due debts, a claim arising under CCC export credit sales program GSM-3 for about $85 million was recognized by that Government and is included in the data in this *Report.*

17. *Other credits (miscellaneous)* includes the credits under Public Law 86-383, Title II, which appropriated funds for loans by the Secretary of the Army to the Ryukyu Electric Power Corporation for construction, installation, and equipment of electric power systems; loans extended by the U.S. Information Agency for binational centers, under provisions of Public Laws 80-402 and 87-256; and credits established in postal debt settlements for claims for reimbursement for services rendered by the U.S. Postal Service.

Other credits (miscellaneous) also includes the extension of credit through acceptance of the asset (in the form of a $114 million credit repayable by Turkey) assigned to the U.S. Government as part of its recovery of the residual capital of the European Payments Union, as described in paragraph 3, above.

18. Public Law 92-224 created the Federal Financing Bank (FFB), an instrumentality of the U.S. Government. FFB purchases and sells obligations which are issued, sold, or guaranteed by Federal agencies. In this section of this *Report,* such transactions are classified with those of the program providing the guarantees: FFB has committed and disbursed upon loans extended under guaranty from the Overseas Private Investment Corporation and

[2] H. Doc. No. 154, 87th Cong., 1st sess.

from the Defense Department under the Foreign Military Sales Act, as described in paragraphs 3 and 4, above.

Definitions

Although there exists a wide variety of transactions and differences in the statistical and accounting procedures of the various Government agencies, and it is not possible to prepare simple definitions applicable to all cases, it is believed that the following classifications used in this section are generally consistent.

1. *Utilized* assistance is measured generally in terms of goods delivered or shipped, services rendered, or cash disbursed by the U.S. Government to or for the account of a foreign government or other foreign entity. Utilized assistance thus represents the goods transferred, the services rendered, or the cash disbursed depending upon the mechanics of furnishing the aid. However, many services are rendered which are not included in foreign assistance.

Reverse grants and returns on grants and collections on credits are measured in similar fashion.

Utilized grants represent the tangible foreign assistance that has moved either as an outright or conditional gift, or subject to future settlement. Utilized credits represent the tangible foreign assistance that has moved subject to repayment of the principal amount and, usually, of interest.

Utilizations under several aid programs shown in *Table B–2* include credits extended to refinance principal collections and to capitalize interest. Many agreements for the reorganization of the debt of developing countries are recorded as utilizations of the new (reorganization) credits offset by principal collections and interest received.

For a more itemized explanation of "utilized," by the aid programs shown in *Table B–2,* refer to the sections on *Transactions covered* (pp. 39–50) in the explanatory note in the *Report* for January–June 1960,[2] as amended by the notes in the preceding sections of this Explanatory Note.

2. *Returned* represents returns of grants (such as lend-lease merchant ships), cash settlements for grants, and reverse grants (such as lend-lease and counterpart funds furnished the U.S. Government under the Foreign Assistance Act program and earlier economic cooperation programs).

3. *Repaid* represents payments received and applied to the reduction of outstanding principal indebtedness, excluding principal repayments on debts arising out of World War I. Repayments on guaranteed loans, where Government money was not disbursed, are excluded. Amounts charged off, or changes in outstanding indebtedness due to exchange rate variations, are excluded (see *Table B–10*).

Repayments include amounts applied to principal by utilization of refinancing credits.

Sales of promissory notes (or other evidences of indebtedness) to foreigners, either in the country of the borrower or a third country, are included in principal collections. Such "principal collection" is recorded against the country of the borrower in this *Report.*

4. *Interest and commissions* represents payments received on *credit transactions* (which see) and applied to income, and includes, in addition to interest on outstanding indebtedness, any regular collections for service charges, commitment fees on undisbursed balances, and the commissions which a Government agency, such as the Export-Import Bank, collects when a private institution participates in a loan of the agency. Interest payments on debts arising out of World War I are *not* included nor is interest received on deposits in foreign banks (including funds acquired under agricultural sales programs).

Interest includes capitalized interest which is reported as having been realized through recording of an additional credit utilization which, in turn, increases principal indebtedness outstanding.

5. *Outstanding indebtedness* represents the net cumulative difference between (a) credit utilizations and (b) credit repayments, principal charged off, adjustments to outstanding principal for discount allowed for extraordinary prepayments, and the net loss due to exchange rate variations (see footnote 4 to *Table B–10*). This indebtedness covers principal only and does not include accrued interest. The data necessarily include the results of transactions taking place before the period covered. Indebtedness arising out of World War I, however, is excluded. Indebtedness to others, even though at Government guarantee and risk, is excluded.

6. *Authorized* represents the gross amount of grants or credits committed by Government agencies or authorized by acts of Congress. In the case of grants, the word is generally used to mean congressional authorizations, supported by appropriations, where necessary. In the case of credits, the word is generally used to mean the gross amount of loans and other credits approved or committed by Government agencies (including increases in prior commitments), even though in some instances such arrangements may not have been formalized by signed credit agreements. The words "authorized" and "committed" are often used interchangeably in this section.

7. *Expired and canceled* represents in the case of loans and other credits all terminations of credit authority occurring during the period covered regardless of whether the loan or other credit was authorized prior to or during the period.

8. *Net authorizations* means the difference between gross authorizations and expired or canceled authorizations during the period, further decreased by the reduction in Export-Import Bank authorizations as a result of private participation either with or without recourse.

9. *Unutilized credits* (*Table B–9*) represents the difference between cumulative net authorizations by the agency and cumulative utilizations.

10. *Unspecified* for purposes of this *Report* represents transactions which cannot be distributed by country either for security reasons or because the data are not available. In most instances such items have been distributed by area.

Presentation of Data in Tables

The presentation of the data for foreign assistance by the U.S. Government in the tables of this section is com-

[2] H. Doc. No. 154, 87th Cong., 1st sess.

parable with that in the *Report* for July 1, 1972–June 30, 1975.[5]

Table B–1 summarizes, by type and geographical area, data for the postwar period July 1, 1945, through December 31, 1975, appearing in tables published periodically by the Bureau of Economic Analysis, Department of Commerce in the monthly magazine, *Survey of Current Business,* and in the annual *Statistical Abstract of the United States. Table B–2* is a summary of the data for the entire postwar period, by program and period, and *Table B–3,* a summary by geographical area and period. *Tables B–4 through B–6* are summaries of the same data for the major types of net assistance, by geographical area and period. Two supplemental tables separate the data for net credits (*Table B–5*) into the credits utilized (*Table B–5A*) and principal repayments (*Table B–5B*).

Table B–7 is a summary by major program of the activity on foreign credits from July 1, 1940, through December 31, 1975. It facilitates the understanding and reconciliation of the different statistics on credit activity, and is indexed to the other tables. *Table B–8* summarizes the outstanding indebtedness of foreign governments and other foreign entities as of December 31, 1975, by area, country, and major program. (*Table B–8A* summarizes the outstanding indebtedness repayable in U.S. dollars, at the option of the U.S. Government, and *Table B–8B* summarizes the outstanding indebtedness repayable in other than U.S. dollars, at the option of the debtor.) *Table B–9* summarizes the unutilized balances of U.S. Government credit commitments, as of December 31, 1975, by area, country, and major program. *Table B–10* is a summary by major program and by area and country of the activity on foreign credits from July 1, 1945, through December 31, 1975, and also presents data on principal and interest which were reported by the collecting agencies to have been past due 90 days or more as of December 31, 1975. *Table B–11* is a summary by major program and by area and country of the interest and commissions collected from July 1, 1945, through December 31, 1975, by period.

Table B–12 is a summary, by program and by area and country, of the activity on the farm products for foreign currency sales programs, from July 1, 1953, through December 31, 1975.

The figures in each of the tables are rounded to whole millions of dollars, hence components will not necessarily add to totals. Any country whose total or largest dollar amount cannot be rounded to $1 million or more has been combined with other countries in that area whose dollar amounts cannot be rounded to $1 million or more and the total has been rounded and shown as *Other.* In determining whether a country should be shown individually or in combination with other countries in an area, each table has been treated separately.

Whenever the country detail to be shown for an area is one item only (one country or, in accordance with the above, exclusively *Other*) only the area total appears, and this area total is shown even though the figure is less than $1 million. For each country shown, the detail figures for that country appearing in any column are shown, even though in some instances they may be less than $1 million.

Negative entries in the tables are explained as follows: A negative net grant indicates an excess of grant returns over new grants utilized. A negative net credit indicates an excess of principal repayments over new credits utilized.

A negative for "other assistance" indicates an excess in the dollar equivalent of foreign currencies disbursed by the Government over the dollar equivalent of acquisitions through new sales and through other included collections.

[5] H. Doc. No. 94–348.

TABLE B-1.—*Summary of major U.S. Government foreign assistance, military and other, by area and country, postwar period, July 1, 1945, to Dec. 31, 1975* [1]

[In millions of dollars and equivalents]

Area and country	Total (net) [2]	Military supplies and services (net grants) [3]	Other aid (economic and technical assistance): Total (net)	Net grants [4]: Total	Net grants [4]: Gross grants	Net grants [4]: Less reverse grants and returns	Net credits [4]: Total	Net credits [4]: New credits	Net credits [4]: Less principal collections	Other assistance (through net accumulation of foreign currency claims): Total	Currency claims acquired—Through sale of farm products	Currency claims acquired—From 2d-stage operations [5]	Less currencies used—For grants and credits in recipient's currency	Less currencies used—For other purposes
Total, all areas	171,317	64,347	2,960	68,290	70,216	1,926	32,618	64,887	32,270	2,052	14,996	4,202	13,282	3,863
Total, investment in international financial institutions	4,010													
Total, Europe	[3] 54,196	[3] 23,676	30,520	22,929	24,592	1,663	6,969	19,545	12,576	622	3,699	374	1,871	1,580
Total, Western Europe	[3] 52,372	[3] 23,676	28,696	21,812	23,435	1,623	6,570	18,190	11,620	314	3,179	374	1,871	1,368
Austria	1,193	106	1,087	1,045	1,099	54	42	161	119	(*)	56		26	30
Belgium and Luxembourg	1,928	1,255	672	581	583	2	91	348	257	(*)	2			2
Cyprus	39		39	38	38		1	5	4	(*)	2	(*)	1	1
Denmark	936	633	303	234	248	14	69	113	44		4		2	2
Finland	41	(*)	41	4	4		30	191	161	7	48	9	23	27
France	8,546	4,399	4,148	4,183	4,367	184	—38	2,379	2,417	2	251	6	46	208
Germany	3,800	857	2,944	3,831	3,908	77	—886	524	1,410	—1	163		96	68
Greece	4,334	2,460	1,874	1,472	1,547	75	403	723	321	(*)	202	49	158	94
Iceland	59		59	34	36	2	25	61	36	(*)	16	5	12	9
Ireland	78		78	17	18	1	61	171	111	(*)				(6)
Italy	5,506	2,511	2,995	2,773	2,853	81	223	1,289	1,066	(*)	237	5	120	121
Malta	50		50	49	49		1	2	1					
Netherlands	2,217	1,274	942	844	896	51	98	581	483	(*)	9		7	2
Norway	1,438	935	503	217	239	22	286	426	140	(*)	2		1	2
Portugal	523	350	174	56	58	1	117	249	132	(*)	7		3	4
San Marino	1		1	1	1									
Spain	2,069	772	1,297	392	586	194	821	1,465	644	84	710	61	380	306
Sweden	104		104	87	87		17	55	39	(*)				(*)
Switzerland	78		78				78	83	5	(*)				(6)
Turkey	7,019	4,191	2,828	1,150	1,237	87	1,616	1,925	309	63	526	150	332	282
United Kingdom	6,966	1,124	5,842	3,277	3,798	521	2,564	5,637	3,073	(*)	216		96	120
Yugoslavia	2,706	719	1,986	1,047	1,072	25	780	1,435	655	159	729	89	568	91
European Atomic Energy Community	44		44				44	108	64					

European Coal and Steel Community	25		25				25	100	75					
European Payments Union	6		6	6	238	232								
Other and unspecified Western Europe	2,665	2,090	576	474	474		102	157	55					
Total, other Europe	1,824		1,824	1,117	1,156	39	399	1,355	957	308	520			212
Albania	20		20	20	20									
Czechoslovakia	191		191	186	186	(*)	5	13	8					
East Germany	17		17	17	17									
Hungary	18		18	17	17		(*)	18	18					
Poland	905		905	439	440	(*)	157	438	280	308	520			212
Romania	92		92	10	10		82	162	81					
Soviet Union	581		581	426	466	39	154	724	570					
Total, Africa	7,300	392	6,908	3,617	3,710	93	2,874	4,028	1,154	416	1,178	274	789	247
Algeria	398		398	178	178		220	240	20	(*)	(*)			(*)
Angola	6		6				6	11	5					
Benin	19	(*)	19	15	15		4	4	(*)	(*)			(*)	(6)
Botswana	35		35	20	20		15	15						
Burundi	9		9	9	9									
Cameroon	66	(*)	66	27	27		38	41	3					
Cape Verde Islands	1		1	1	1		(*)	(*)						
Central African Republic	11		11	8	8		3	3						
Chad	25		25	25	25									
Congo (Brazzaville)	10		10	10	10			(*)	(*)					
Egypt	1,320		1,320	341	342	(*)	624	921	298	355	809	200	510	144
Ethiopia	512	219	293	188	188		105	150	45	(*)	3	(*)	4	(6)
Gabon	16		16	8	8		9	9						
Gambia	8		8	8	8									
Ghana	267	(*)	266	73	73		190	268	78	3	37	8	24	17
Guinea	127	1	126	51	51		71	77	6	4	32	2	24	6
Guinea-Bissau	1		1	1	1									
Ivory Coast	71	(*)	71	23	23		49	58	10	(*)	3	(*)	2	2
Kenya	116	(*)	116	79	79		37	47	10	(*)	(*)			(*)
Lesotho	27		27	27	27									
Liberia	249	9	240	138	138		102	213	111	(*)				(6)
Libya	224	18	206	206	206		(*)	7	7	(*)			1	(6)
Madagascar	20	(*)	20	14	14		6	6			(*)			(*)
Malawi	36		36	20	20		15	15						
Mali	70	3	67	64	64	(*)	3	3	(*)	(*)	1	(*)	(*)	(*)
Mauritania	21		21	20	20		1	1	(*)					
Mauritius	14		14	14	14									
Morocco	884	52	832	376	376		452	628	176	4	88	23	80	27
Mozambique	1		1	1	1			(*)	(*)					
Niger	69	(*)	69	66	66		3	3	(*)					

See footnotes at end of table.

TABLE B-1.—*Summary of major U.S. Government foreign assistance, military and other, by area and country, postwar period, July 1, 1945, to Dec. 31, 1975* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (net) [2]	Military supplies and services (net grants) [3]	Other aid (economic and technical assistance): Total (net)	Net grants [4]: Total	Net grants [4]: Gross grants	Net grants [4]: Less reverse grants and returns	Net credits [4]: Total	Net credits [4]: New credits	Net credits [4]: Less principal collections	Other assistance (through net accumulation of foreign currency claims): Total	Currency claims acquired—Through sale of farm products	Currency claims acquired—From 2d-stage operations [5]	Less currencies used—For grants and credits in recipient's currency	Less currencies used—For other purposes
Nigeria	371	2	369	267	267	(*)	102	102	11	(*)			(*)	([6])
Rwanda	15		15	15	15	(*)					(*)			(*)
Senegal	66	3	63	58	58		5	5	1	(*)	3	(*)	1	2
Seychelles	1		1	1	1									
Sierra Leone	59		59	47	47		12	15	3	(*)		(*)	(*)	([6])
Somalia	89		89	73	73		16	17	1	(*)		(*)	1	[6] −1
South Africa	−92		−92	−92	(*)	93	(*)	154	154	(*)	(*)			(*)
Sudan	139	1	138	86	86		48	69	21	4	26	2	12	12
Swaziland	8		8	6	6		2	2						
Tanzania	159		159	98	98		61	64	3	(*)	(*)	(*)		(*)
Togo	27		27	25	25	(*)	2	2	(*)					
Tunisia	784	47	737	411	411		304	377	72	22	90	32	91	9
Uganda	45		45	34	34		11	11	(*)					
Upper Volta	45	(*)	45	45	45						(*)			(*)
Zaire	600	32	568	253	253		292	319	27	23	85	5	39	28
Zambia	36		36	6	6		30	49	19				(*)	([6])
East African Common Services Organization	2		2				2	3	1					
Other and unspecified Africa	317	5	312	276	276		36	108	72					
Total, Western Hemisphere	13,039	1,324	11,715	3,911	3,914	3	7,543	13,595	6,052	262	898	95	496	236
Antigua	1		1	1	1		1	2	1					
Argentina	462	86	376	21	21		349	1,056	708	6	31	1	15	10
Bahamas	29		29	(*)	(*)		29	54	25					
Barbados	2		2	1	1		(*)	1	(*)					
Belize	7		7	7	7		(*)	(*)	(*)					
Bermuda	18		18				18	28	10					
Bolivia	635	44	591	330	330	1	260	308	49	1	68	13	57	22
Brazil	3,430	303	3,127	598	598		2,335	3,992	1,657	194	510	21	247	90
Cayman Islands	12		12				12	14	2					
Chile	1,565	139	1,426	238	238	(*)	1,165	2,031	866	23	85	14	49	28

Colombia	1,335	123	1,211	284	284	(*)	912	1,332	420	16	66	21	40	32
Costa Rica	201	2	200	114	114		85	137	52		(*)			(*)
Cuba	57	16	41	5	5	(*)	36	40	3					
Dominica	1		1	1	1									
Dominican Republic	545	33	512	251	251	(*)	262	330	68	(*)	(*)	1		1
Ecuador	309	61	247	136	136	(*)	110	211	101	1	12	3	8	6
El Salvador	153	9	144	76	76		68	93	26	(*)	(*)			(*)
Grenada	1		1	1	1									
Guadeloupe														
Guatemala	329	29	299	213	213		86	128	42	(*)	9		9	(*)
Guyana	79		79	26	26		53	53	(*)	(*)	(*)	(*)		(*)
Haiti	143	4	139	115	115	(*)	24	39	15			(*)		(*)
Honduras	172	13	159	90	90		69	89	21	(*)	(*)	(*)		(*)
Jamaica	138	1	137	48	48		89	126	36		(*)			(*)
Mexico	709	2	707	159	159	(*)	548	1,465	917	(*)	25	6	18	13
Netherlands Antilles	3		3				3	3	(*)					
Nicaragua	225	21	204	89	89		115	152	38		(*)			(*)
Panama	322	8	314	136	136		178	237	59	(*)				(6)
Paraguay	157	22	135	77	77	(*)	57	88	32	(*)	16	4	12	8
Peru	633	139	493	226	226	(*)	265	702	437	2	40	8	26	20
Surinam	9		9	5	5		4	7	3					
Trinidad and Tobago	56		56	35	35		21	39	18					
Uruguay	214	66	148	31	31	(*)	100	135	35	18	36	3	16	6
Venezuela	277	17	260	66	66	(*)	194	538	344	(*)				(6)
Central American Bank for Economic Integration	127		127	(*)	(*)		127	132	5					
Central American Monetary Stabilization Fund	10		10				10	10						
Caribbean Development Bank	8		8				8	8						
Other and unspecified Western Hemisphere	666	184	482	531	533	2	−49	13	62					
Total, Asia	[3] 84,081	[3] 38,501	45,579	30,327	30,470	143	14,501	25,793	11,292	752	9,220	3,459	10,126	1,801
Afghanistan	442	5	437	343	343		90	136	45	4	6	2	1	4
Bangladesh	701		701	311	311		389	389	(*)	(*)	(*)	(*)		(*)
Brunei	20		20				20	20						
Burma	202	89	113	58	58	1	47	61	13	8	48	11	37	13
Cambodia [7]	2,158	1,311	847	638	640	2	207	286	79	3	18	79	88	7
China (Taiwan)	7,148	4,514	2,634	1,901	1,909	8	731	1,177	447	2	493	31	410	112
Hong Kong	79		79	43	43		35	37	1	1	1			1
India	9,100	114	8,986	4,553	4,582	29	3,995	7,271	3,277	438	145	2,441	5,518	629
Indonesia	2,140	168	1,972	412	418	6	1,337	1,748	411	222	292	19	60	28
Iran	2,290	896	1,394	460	474	14	935	1,864	929	−1	64	20	42	42
Iraq	88	50	39	31	31	(*)	8	27	19					
Israel	4,633	1,584	3,050	1,073	1,074	(*)	1,941	2,797	855	35	412	176	406	147

See footnotes at end of table.

TABLE B-1.—*Summary of major U.S. Government foreign assistance, military and other, by area and country, postwar period, July 1, 1945, to Dec. 31, 1975* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (net) [2]	Military supplies and services (net grants) [3]	Other aid (economic and technical assistance)											
			Total (net)	Net grants [4]			Net credits [4]			Other assistance (through net accumulation of foreign currency claims)				
											Currency claims acquired—		Less currencies used—	
				Total	Gross grants	Less reverse grants and returns	Total	New credits	Less principal collections	Total	Through sale of farm products	From 2d-stage operations [5]	For grants and credits in recipient's currency	For other purposes
Japan and Ryukyu Islands	4,136	1,668	2,469	2,634	2,643	9	–166	2,780	2,945	(*)	193	...	116	78
Jordan	1,141	205	936	847	847	(*)	89	129	40	(*)	6	2	4	5
Korea	11,606	5,715	5,891	4,478	4,505	27	1,395	1,790	395	18	1,030	97	866	242
Kuwait	...	...	...	...	...	...	...	50	50	...	...	...	...	...
Laos [7]	2,555	1,649	906	906	906	(*)	(*)	(*)	...	(*)	(*)	...	(*)	...
Lebanon	184	15	169	108	108	...	61	89	29	(*)	...	1	...	1
Macao	5	...	5	5	5	...	...	...	...	...	...	...	...	...
Malaysia	117	2	115	55	55	...	60	132	72	(*)	(*)	...	...	(6)
Nepal	194	2	192	184	184	...	3	4	1	5	...	2	4	[6] –7
Pakistan	5,329	691	4,638	1,958	1,992	34	2,542	2,914	373	138	1,321	160	1,205	137
Philippines	2,342	715	1,627	1,243	1,249	7	375	838	463	10	142	22	110	45
Saudi Arabia	71	38	33	31	31	...	2	266	264	...	...	...	...	...
Singapore	78	...	78	2	2	...	75	76	1	...	(*)	...	...	(*)
Sri Lanka (Ceylon)	242	3	239	104	104	...	133	159	26	3	34	6	21	17
Syria	73	(*)	73	34	34	...	30	33	3	8	35	1	12	16
Thailand	1,922	1,279	643	558	561	4	85	163	78	(*)	5	2	2	5
Vietnam [7]	23,521	16,837	6,684	6,731	6,731	...	96	555	459	–143	973	387	1,225	278
Yemen (Aden)	3	...	3	3	3	...	...	...	...	...	...	...	...	...
Yemen (Sana)	63	(*)	63	63	63	...	...	...	...	...	...	...	...	...
Asian Development Bank	1	...	1	1	1	...	...	...	...	...	...	...	...	...
Other and unspecified Asia	1,497	952	545	559	561	2	–14	2	16	...	...	...	...	...
Total, Oceania	[3] 1,035	[3] 3	1,032	619	639	20	413	1,279	866	(*)	...	...	...	(*)
Australia	277	...	277	–7	13	20	285	1,053	769	(*)	...	...	...	(6)
British Solomon Islands	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Fiji	6	...	6	6	6	...	...	...	...	...	...	...	...	...
New Caledonia	1	...	1	...	...	...	1	2	(*)	...	...	...	...	...
New Zealand	102	3	99	2	2	...	97	193	96	...	...	...	...	...
Papua New Guinea	31	...	31	(*)	(*)	...	30	30	...	...	...	...	...	...
Solomon Islands	2	...	2	2	2	...	...	...	...	...	...	...	...	...

Tonga Islands	5		5	5	5						
Trust Territory of the Pacific Islands	607		607	607	607		(*)	1	1		
Western Samoa	5		5	5	5						
Other and unspecified Oceania	(*)		(*)	(*)	(*)						
Canada	275	9	266				266	506	241	(*)	(*)
Other international organizations and unspecified, all areas	7,383	443	6,940	6,888	6,892	4	52	141	89		

*Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

[2] Includes "Investment in international financial institutions" not shown in a separate column.

[3] Military supplies and services grant data were reported by the Defense Department between 1949 and 1975 under varying security restrictions. Despite subsequent withdrawal of many of these restrictions, data for activities under Public Laws 83–665 and 87–195 are generally not available in sufficient detail to show military supplies and services by country and by calendar year. They are thus shown only in area totals elsewhere in this *Report*. However, "Foreign Military Sales and Military Assistance Facts," indicating accomplishment of selected grant assistance to most countries, by fiscal years, has been published by the Defense Department (November 1975). Although amounts included in that Defense Department release (incorporating unpublished amendments and revisions) are not exactly equivalent to the amounts reported by the Defense Department between 1949 and 1975 for inclusion by area in this report, such available country data have been incorporated into this table. Offsetting adjustments have been made in the "Unspecified" categories to retain the area totals originally recorded. The "Unspecified" categories also include values of some military aid where data remain classified because of intergovernmental agreement or because of their sensitive nature.

Data on a calendar year basis in tables B–3 and B–4 for military assistance to Afghanistan, India, Iran, Iraq, Jordan, Lebanon, Nepal, Pakistan, Saudi Arabia, Sri Lanka (Ceylon), Syria, and Yemen (Sana) are not available; consequently, the amounts for these countries, along with those for Greece and Turkey, are included in the data for Western Europe in those tables. Similarly, military grant aid to New Zeland is included in the data for Asia in tables B–3 and B–4.

Credits which finance the sale of military supplies and services are not included here; they are included as part of credits.

[4] New credits do not include $3,682,954,000 representing settlements for postwar relief and other grants under agreements, including that for the reversion of the Ryukyu Islands to Japan. New grants have not been adjusted for any part of these settlements. For major countries these amounted to: Germany, $1,000,000,000; Soviet Union, $838,595,000; Japan, $810,000,000; United Kingdom, $562,447,000; France, $353,300,000; and Netherlands, $47,160,000. Although settlements have not been reached with China, for statistical convenience the amount of postwar lend-lease credits ($50,345,000) is included in the total of "settlements" noted here, and thus reported in grants rather than credits.

[5] Includes foreign currencies acquired from triangular trade operations and principal and interest collections on credits, originally extended under Public Law 83–480, which—since enactment of Public Law 87–128—are available for the same purpose as Public Law 83–480 currencies.

[6] Currency of one country used for intercountry transfers is included in uses for that country, but the equivalent amount is deducted from uses for the second country, to which the United States transfers its claim. This results in a negative entry in this column in those instances where the value of the U.S. claim transferred to the second country exceeds the value of currency used in it. If a specific negative value is not shown for a country, then the excess of value of the U.S. claim transferred to this country over the value of currency used in it is less than $500,000.

[7] Separate detail data for Cambodia, Laos, and Vietnam became available during 1954. For earlier periods data for Indochina are included in "Unspecified Asia."

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-2.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, gross and returned, by type and by program* [1]

[In millions of dollars and equivalents]

Type and program	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Net total, all programs	171,317	8,693	7,322	6,804	8,242	7,468	5,895	126,894
INVESTMENT IN INTERNATIONAL FINANCIAL INSTITUTIONS								
Total	4,010	654	537	373	271	246	234	1,695
Asian Development Bank	110	30	2	12	17		10	40
Inter-American Development Bank	1,621	268	192	197	180	175	165	444
International Bank for Reconstruction and Development	648			12	1			635
International Development Association	1,595	357	344	152	73	71	58	540
International Finance Corporation	35							35
GRANTS								
Net	132,637	5,162	7,380	4,790	6,700	5,622	4,484	98,500
Gross (new) [2]	135,084	5,168	7,389	4,920	6,820	5,625	4,488	100,675
Military aid	64,868	2,920	2,849	2,862	4,529	3,582	2,751	45,376
Under Foreign Assistance Act and related programs:								
Military supplies and services [3]	40,483	839	975	838	770	789	616	35,657
Multilateral-construction program contributions	1,462	38	88	43	35	34	36	1,189
Military assistance, service funded	18,169	1,396	849	1,981	3,629	2,583	2,100	5,630
Vessel loans	586	(4)	(4)	(4)	(4)	(4)	(4)	[4] 586
Japanese military aid	540							540
Chinese military aid	120							120
Korean military aid	271				95	176		
Financing of military purchases	1,584	647	937					
Lend-lease	679							679
Greek-Turkish aid	530							530
Chinese naval aid	141							141
Philippine military aid	132							132
Military equipment "loans" (other than under Foreign Assistance Act)	171	(4)	(4)	(4)	(4)	(4)	(4)	[4] 171
Other	70,216	2,248	4,540	2,059	2,290	2,043	1,737	55,299
Under Foreign Assistance Act and related programs	42,090	1,554	1,562	1,335	1,388	1,230	1,016	34,005
Under authorizations for farm products disposals:								
From foreign currencies under the Agricultural Trade Development and Assistance Act	6,282	20	2,316	197	273	251	186	3,040
For famine, other urgent, and extraordinary relief, for economic development, and through private welfare agencies [5]	6,096	309	316	247	351	304	283	4,287
Payment of transportation	1,440	119	121	81	132	97	98	792
Civilian supplies and lend-lease	7,193				1	6	13	7,172
UNRRA, post-UNRRA, and interim aid	3,443							3,443
Philippine rehabilitation	676							676
Inter-American aid and technical assistance	145							145
Inter-American and related highways	179	9	8	5	3	2	3	148
International refugee assistance	534	87	59	52	14	19	7	295

See footnotes at end of table.

TABLE B-2.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, gross and returned, by type and by program* [1]—Continued

[In millions of dollars and equivalents]

Type and program	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
GRANTS—Continued								
International children's assistance	81							81
Greek-Turkish aid	122							122
Chinese stabilization	120							120
Yugoslav aid	38							38
Trust territory development	574	77	71	62	55	51	47	211
Peace Corps	1,144	72	88	80	72	84	84	664
Libyan special purpose funds	36							36
Berlin investment fund	13							13
American Red Cross	10							10
Other	(*)		(*)	(*)	(*)	(*)	(*)	(*)
Less reverse grants and returns	2,446	6	9	130	120	3	3	2,175
Military aid	520	4	7	10	2	2	3	493
Under Foreign Assistance Act and related programs:								
Foreign currency collections [6]	186	4	7	10	2	2	3	158
Return of vessel "loans"	5	([4])	([4])	([4])	([4])	([4])	([4])	[4]5
Settlement for reversionary rights on military assistance	75							75
Return of lend-lease ships	189							189
Return of military equipment (other than under Foreign Assistance Act)	65	([4])	([4])	([4])	([4])	([4])	([4])	[4]65
Other	1,926	2	2	120	118	1	1	1,683
Under Foreign Assistance Act and related programs:								
Dollar cash return	125			118				6
Other	1,234	(*)	(*)	(*)	114	1	1	1,118
Civilian supplies, lend-lease, and cash settlements for grants	561				3			558
Other	7	2	2	2				(*)
CREDITS								
Net	32,618	2,848	−348	1,690	1,484	1,845	1,278	23,820
Gross (new) [2]	64,887	5,293	4,468	4,252	3,534	3,935	2,991	40,414
Under Export-Import Bank Act	25,033	2,490	2,577	1,680	1,298	1,426	1,091	14,472
Under Foreign Assistance Act and related programs:								
Country program loans	15,850	620	583	614	554	886	887	11,707
Social Progress Trust Fund	713	21	24	34	26	23	47	536
Deficiency and basic materials development	147							147
Financing of military purchases	3,345	823	550	478	372	486	142	493
Investment incentive credits	116	68	29	7	6	3	2	
Under Agricultural Trade Development and Assistance Act:								
Currency loans to foreign governments	5,176	2	9	8	22	93	131	4,910
Currency loans to private enterprises	418	1	4	7	31	39	18	318
Long-term dollar credits	5,448	949	547	572	647	583	497	1,653
Lend-lease and surplus property	1,658			42		47	1	1,567

See footnotes at end of table.

TABLE B-2.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, gross and returned, by type and by program* [1]—Continued

[In millions of dollars and equivalents]

Type and program	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
CREDITS—Continued								
Other credits	6,984	318	145	809	578	349	175	4,610
British loan	3,750							3,750
Occupied-areas commodity credits	283							283
Reconstruction Finance Corporation loans	70							70
United Nations loans	141							141
Philippine funding	37							37
Under Atomic Energy Act	84	(*)	−2	10	5	9	−1	64
Under Commodity Credit Corporation Charter Act	2,433	318	147	799	459	339	176	195
Miscellaneous	186	(*)	(*)	−1	114	2	1	70
Less principal collections	32,270	2,444	4,816	2,562	2,050	2,090	1,713	16,594
Under Export-Import Bank Act	15,543	992	1,111	1,089	1,048	1,220	1,099	8,983
Under Foreign Assistance Act and related programs:								
Country program loans	3,426	304	529	229	194	275	194	1,701
Social Progress Trust Fund	207	31	29	26	24	20	20	57
Deficiency and basic materials development	133	1	1	3	1	1	1	127
Financing of military purchases	1,075	180	185	145	75	80	46	364
Investment incentive credits	16	11	5	1	(*)	(*)	(*)	....
Under Agricultural Trade Development and Assistance Act:								
Currency loans to foreign governments	2,464	108	1,874	117	78	45	35	206
Currency loans to private enterprises	218	16	18	18	19	21	21	104
Long-term dollar credits	1,250	111	373	280	142	104	64	175
Lend-lease, surplus property, and settlements for grants and war accounts	4,116	130	103	248	193	126	86	3,231
Other credits	3,820	562	589	405	277	197	146	1,645
British loan	1,192	71	70	69	67	66	65	785
Occupied-areas commodity credits	283							283
Reconstruction Finance Corporation loans	365							365
United Nations loans	89	6	5	5	5	5	5	57
Philippine funding	37							37
Under Atomic Energy Act	27	5	3	9	1	4	3	3
Under Commodity Credit Corporation Charter Act	1,763	478	510	321	203	120	72	58
Miscellaneous	64	1	1	1	1	1	(*)	58
OTHER ASSISTANCE (THROUGH NET ACCUMULATION OF FOREIGN CURRENCY CLAIMS)								
Net	2,052	29	−247	−49	−213	−246	−101	2,880
Farm product sales	14,996	5	1	5	75	164	287	14,458
Under Mutual Security Acts	2,031							2,031
Under Agricultural Trade Development and Assistance Act	12,922	(*)	....	5	74	164	287	12,392
Under Commodity Credit Corporation Charter Act	43	5	1	1	1	(*)	(*)	35

See footnotes at end of table.

TABLE B-2.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, gross and returned, by type and by program* [1]—Continued

[In millions of dollars and equivalents]

Type and program	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
CREDITS—Continued								
From 2d-stage operations (under Agricultural Trade Development and Assistance Act) [7] ...	4,202	183	2,213	356	270	175	164	842
Less currencies disbursed for grants, credits, and other uses ...	17,146	159	2,461	410	558	585	552	12,421
Under Mutual Security Acts ...	2,000	1	(*)	(*)	1	1	2	1,995
For economic grants and credits in recipient's currency ...	1,552	1	(*)	(*)	(*)	1	1	1,548
Other ...	447	(*)	(*)	(*)	(*)	(*)	(*)	446
Under Agricultural Trade Development and Assistance Act ...	15,103	153	2,460	409	556	584	550	10,391
For economic grants and credits in recipient's currency ...	11,730	20	2,319	207	317	374	328	8,166
Other ...	3,373	133	142	202	239	210	222	2,224
Under Commodity Credit Corporation Charter Act: Other than for grants and credits ...	43	5	1	1	1	(*)	(*)	35

* Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

[2] New credits do not include $3,682,954,000 representing settlements for postwar relief and other grants under agreements. New grants have not been adjusted for any part of these settlements.

[3] Includes contributions to mutual special weapons projects.

[4] Data not available, 1963–75; to be revised.

[5] Includes donations through United Nations Children's Fund, United Nations Relief and Works Agency for Palestine Refugees, and World Food Program.

[6] Also includes some dollars deposited by foreign governments in payment of foreign currencies owed to the United States.

[7] Includes foreign currencies acquired from triangular trade operations and principal and interest collections on credits, originally extended under Public Law 83–480, which—since enactment of Public Law 87–128—are available for the same purposes as Public Law 83–480 currencies.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-3.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Total, all areas [2]	167,307	8,039	6,785	6,432	7,971	7,221	5,661	25,199
Military supplies and services [3]	64,347	2,916	2,842	2,852	4,527	3,580	2,748	44,883
Other [4]	102,960	5,122	3,943	3,580	3,444	3,642	2,913	80,316
Total, Europe	55,825	526	494	780	347	291	83	53,304
Total, Western Europe	54,002	584	596	410	278	292	79	51,762
Military supplies and services [3]	25,305	115	279	323	281	333	266	23,709
Other [4]	28,696	469	318	88	−4	−41	−187	28,054
Austria	1,087	−2	−2	−2	(*)	9	−6	1,091
Belgium and Luxembourg	672	18	15	3	−6	−9	5	646
Cyprus	39	14	1	−1	1	1	3	20
Denmark	303	15	10	24	−1	−5	−1	261
Finland	41	7	(*)	−6	−2	(*)	−8	50
France	4,148	−15	−11	12	32	7	−27	4,150
Germany	2,944	33	46	8	3	6	−16	2,865
Greece	1,874	112	65	43	−9	−10	(*)	1,673
Iceland	59	3	−3	−3	−2	−2	−2	68
Ireland	78	−18	−15	−10	−5	−20	23	123
Italy	2,995	−13	−8	11	−15	−7	−8	3,036
Malta	50	15	5	11	12	1	1	5
Netherlands	942	56	34	52	38	2	(*)	761
Norway	503	92	95	38	42	6	−2	231
Portugal	174	15	7	11	16	−6	−34	166
San Marino	1							1
Spain	1,297	94	91	106	−16	−17	1	1,039
Sweden	104	4	6	−1	−3	−1	2	97
Switzerland	78	28	14	24	12	1	(*)	(*)
Turkey	2,828	72	121	65	164	109	88	2,209
United Kingdom	5,842	−89	−162	−132	−208	−138	−143	6,713
Yugoslavia	1,986	38	−27	−44	55	26	−36	1,975
European Atomic Energy Community	44	−6	−5	−1	2	(*)	−27	81
European Coal and Steel Community	25	−6	−5	−5	−5	−5	−5	56
European Payments Union	6			−118	−114			238
Other and unspecified Western Europe	576	1	48	3	6	14	6	498
Total, other Europe (other than military) [4]	1,824	−58	−102	369	70	−2	5	1,542
Albania	20							20
Czechoslovakia	191							191
East Germany	17							17
Hungary	18	−1	−1	1	(*)	−1	(*)	19
Poland	905	9	−24	11	−22	−13	−19	964
Romania	92	20	27	−1	−10	23	33	
Soviet Union	581	−86	−104	359	102	−10	−10	330
Total, Africa	7,300	507	508	289	265	474	294	4,964
Military supplies and services	392	19	16	11	12	20	19	295
Other [4]	6,908	488	492	278	253	454	275	4,669
Algeria	398	41	115	50	2	12	1	177
Angola	6	(*)	−1	1	(*)	−1	(*)	7
Benin	19	2	3	(*)	1	1	1	11
Botswana	35	8	4	8	4	2	3	7

See footnotes at end of table.

TABLE B-3.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]—Continued

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Burundi	9	1	(*)	(*)	(*)	1	(*)	6
Cameroon	66	5	1	3	12	6	10	28
Cape Verde Islands	1	1						
Central African Republic	11	1	1	1	3	(*)	(*)	5
Chad	25	4	8	1	1	(*)	(*)	10
Congo (Brazzaville)	10	1	1		(*)	(*)	(*)	9
Egypt	1,320	87	27	–20	–6	106	(*)	1,126
Ethiopia	293	30	26	18	14	21	9	176
Gabon	16	4	4	2	(*)	(*)	(*)	7
Gambia	8	1	1	2	1	1	(*)	2
Ghana	266	6	1	6	15	15	2	220
Guinea	126	9	6	8	3	7	4	89
Guinea-Bissau	1	1						
Ivory Coast	71	1	3	16	8	6	12	26
Kenya	116	8	9	6	6	19	6	63
Lesotho	27	4	5	3	3	4	4	5
Liberia	240	–1	–2	–3	2	5	(*)	240
Libya	206			(*)	(*)	(*)	(*)	206
Madagascar	20	2	1	(*)	1	2	2	13
Malawi	36	5	4	1	2	3	4	17
Mali	67	11	22	8	3	4	2	18
Mauritania	21	3	9	4	2	1	(*)	2
Mauritius	14	2	4	1	3	1	1	1
Morocco	832	8	30	13	21	70	64	626
Mozambique	1	1			(*)	(*)	(*)	
Niger	69	10	29	10	2	1	2	14
Nigeria	369	7	10	24	29	48	36	215
Rwanda	15	3	1	(*)	1	1	1	8
Senegal	63	8	7	8	2	4	1	32
Seychelles	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Sierra Leone	59	4	3	2	3	4	2	41
Somalia	89	6	(*)	1	3	7	5	67
South Africa	–92	(*)				(*)	–2	–91
Sudan	138	13	7	16	10	–1	–2	95
Swaziland	8	2	1	2	2	1	1	1
Tanzania	159	37	11	8	8	11	9	74
Togo	27	3	3	2	1	2	1	14
Tunisia	737	12	17	12	36	37	49	574
Uganda	45	(*)	1	2	4	5	5	28
Upper Volta	45	6	11	7	4	4	1	13
Zaire	568	96	63	11	20	13	11	353
Zambia	36	5	9	8	1	6	(*)	8
East African Common Services Organization	2	(*)	(*)	(*)	(*)	(*)	(*)	2
Other and unspecified Africa	312	34	33	36	25	29	27	127
Total, Western Hemisphere	13,039	798	736	490	459	404	556	9,595
Military supplies and services	1,324	26	24	25	26	25	25	1,173
Other [4]	11,715	773	713	465	433	379	531	8,422
Antigua	1	(*)	(*)		(*)	(*)	(*)	2
Argentina	376	–4	–4	–11	5	22	20	348
Bahamas	29	21	–1	–2	–3	–11	–3	28
Barbados	2	1	(*)	(*)	(*)	(*)	(*)	(*)
Belize	7	(*)	1	(*)	(*)	(*)	(*)	5

See footnotes at end of table.

TABLE B-3.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]—Continued

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years						July 1, 1945, to Dec. 31, 1969
		1975	1974	1973	1972	1971	1970	
Bermuda	18	−5	−2	11	13	....	....	....
Bolivia	591	11	26	10	38	18	24	465
Brazil	3,127	193	263	79	53	98	93	2,348
Cayman Islands	12	2	10	....	....	....	....	....
Chile	1,426	128	84	28	16	−16	56	1,131
Colombia	1,211	36	45	95	65	83	118	771
Costa Rica	200	10	9	10	11	10	8	143
Cuba	41	....	....	....	....	....	....	41
Dominica	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Dominican Republic	512	36	10	19	25	21	33	369
Ecuador	247	6	7	11	9	10	8	197
El Salvador	144	7	4	9	9	7	10	99
Grenada	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Guatemala	299	20	17	15	17	11	10	209
Guyana	79	16	5	4	6	9	5	35
Haiti	139	11	3	4	3	3	4	111
Honduras	159	24	13	10	10	8	10	86
Jamaica	137	25	22	18	7	14	8	43
Mexico	707	70	95	−4	−10	−18	−1	576
Netherlands Antilles	3	....	3	....	(*)	(*)	(*)	....
Nicaragua	204	13	18	20	6	13	21	114
Panama	314	23	29	42	20	13	15	172
Paraguay	135	7	7	5	7	12	6	92
Peru	493	49	−19	43	48	16	13	343
Surinam	9	1	(*)	(*)	(*)	(*)	(*)	9
Trinidad and Tobago	56	(*)	6	1	3	−1	−2	49
Uruguay	148	(*)	1	5	19	8	9	106
Venezuela	260	−18	−13	−16	3	−19	16	307
Central American Bank for Economic Integration	127	14	12	14	15	23	11	38
Central American Monetary Stabilization Fund	10	10	....	....	....	....	....	....
Caribbean Development Bank	8	5	2	1	....	....	....	....
Other and unspecified Western Hemisphere	482	63	60	49	37	46	40	187
Total, Asia	82,454	5,432	4,235	4,340	6,244	5,455	4,236	52,513
Military supplies and services	36,875	2,750	2,518	2,490	4,203	3,195	2,435	19,283
Other [4]	45,579	2,682	1,717	1,849	2,041	2,260	1,800	33,230
Afghanistan	437	17	9	30	22	20	2	336
Bangladesh	701	380	105	137	79	....	....	....
Brunei	20	....	(*)	4	3	12	....	....
Burma	113	−1	(*)	1	3	3	1	107
Cambodia [5]	847	78	288	128	72	24	(*)	257
China (Taiwan)	2,634	191	119	39	26	14	14	2,231
Hong Kong	79	19	13	(*)	3	(*)	(*)	43
India	8,986	243	−182	67	112	469	434	7,843
Indonesia	1,972	164	125	160	159	135	189	1,040
Iran	1,394	−103	37	221	72	196	58	913
Iraq	39	−2	−2	−2	−2	(*)	−2	48
Israel	3,050	803	199	238	249	377	84	1,101
Japan and Ryukyu Islands	2,469	10	2	−230	−60	−60	−40	2,845
Jordan	936	63	57	64	107	48	14	584
Korea	5,891	313	63	214	221	194	198	4,687
Kuwait	....	−5	−10	−10	−10	....	....	35

See footnotes at end of table.

TABLE B-3.—*Summary of major U.S. Government net foreign assistance, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]—Continued

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Laos [5]	906	14	36	54	48	56	53	644
Lebanon	169	37	22	4	5	–1	7	96
Macao	5	(*)	....	(*)	(*)	(*)	(*)	5
Malaysia	115	3	19	–5	15	–1	–2	85
Nepal	192	8	10	12	13	9	11	129
Pakistan	4,638	134	122	134	154	216	242	3,636
Philippines	1,627	76	43	71	70	55	63	1,249
Saudi Arabia	33	–11	–21	–17	–4	–13	–16	114
Singapore	78	15	26	34	1	(*)	1	1
Sri Lanka (Ceylon)	239	20	2	24	20	14	11	148
Syria	73	18	(*)	(*)	–1	(*)	(*)	56
Thailand	643	10	19	21	19	29	34	510
Vietnam [5]	6,684	159	585	438	539	427	418	4,119
Yemen (Aden)	3	1	1	1	(*)	(*)	(*)	(*)
Yemen (Sana)	63	6	8	2	(*)	(*)	3	45
Asian Development Bank	1	....	....	....	....	(*)	1	(*)
Other and unspecified Asia	545	22	20	16	106	36	20	325
Total, Oceania (other than military) [4]	1,032	88	30	18	97	90	53	655
Australia	277	–23	–62	–59	39	26	–17	372
Fiji	6	1	1	1	1	1	(*)	1
New Caledonia	1	....	....	....	....	....	....	1
New Zealand	99	30	16	8	–5	(*)	8	42
Papua New Guinea	31	(*)	(*)	3	5	10	13	(*)
Solomon Islands	2	(*)	(*)	(*)	(*)	(*)	(*)	1
Tonga Islands	5	(*)	1	1	(*)	(*)	(*)	2
Trust Territory of the Pacific Islands	607	79	73	64	57	53	48	233
Western Samoa	5	1	1	1	(*)	(*)	(*)	2
Other and unspecified Oceania	(*)	(*)	....	....	....	....	....	(*)
Canada	275	45	87	65	28	28	9	12
Military supplies and services	9	....	....	....	....	....	....	9
Other	266	45	87	65	28	28	9	3
Other international organizations and unspecified, all areas	7,383	641	696	449	531	479	430	4,156
Military supplies and services	443	6	6	3	5	6	4	414
Other [4]	6,940	635	690	447	526	473	427	3,742

*Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Military grant aid is shown by area only; country detail is shown for other net grants and for net credits.

[2] Does not include $4,009,803,000 investment in international financial institutions, shown in tables B-1 and B-2.

[3] Includes contributions to the multilateral-construction program of the North Atlantic Treaty Organization and contributions to mutual special weapons projects.

[4] Includes development assistance, technical assistance, and relief.

[5] Separate detail data for Cambodia, Laos, and Vietnam became available during 1954. For earlier periods data for Indochina are included in "Unspecified Asia."

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B–4.—*Summary of U.S. Government net foreign grants, July 1, 1945, to Dec. 31 1975, by area, type, and country* [1]

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Total, all areas	132,637	5,162	7,380	4,790	6,700	5,622	4,484	98,500
Military supplies and services [2]	64,347	2,916	2,842	2,852	4,527	3,580	2,748	44,883
Other [3]	68,290	2,246	4,538	1,938	2,173	2,043	1,736	53,617
Total Europe	48,234	151	295	234	205	355	295	46,699
Total, Western Europe	47,117	151	294	233	204	350	286	45,598
Military supplies and services [2]	25,305	115	279	323	281	333	266	23,709
Other [3]	21,812	36	15	–89	–77	17	21	21,889
Austria	1,045							1,045
Belgium and Luxembourg	581							581
Cyprus	38	14	1	1	2	1	(*)	19
Denmark	234	(*)						234
Finland	4							4
France	4,183							4,183
Germany	3,831							3,831
Greece	1,472	(*)	(*)	(*)	(*)	(*)	(*)	1,471
Iceland	34							34
Ireland	17							17
Italy	2,773			(*)	(*)	(*)	(*)	2,772
Malta	49	14	5	12	12	(*)	1	5
Netherlands	844							844
Norway	217							217
Portugal	56	(*)					(*)	56
San Marino	1							1
Spain	392	3	3	3				384
Sweden	87							87
Turkey	1,150	4	6	13	22	15	18	1,071
United Kingdom	3,277							3,277
Yugoslavia	1,047		(*)		(*)	(*)	(*)	1,047
European Payments Union	6			–118	–114			238
Other and unspecified Western Europe	474	(*)	(*)	1	(*)	(*)	(*)	472
Total, other Europe (other than military) [3]	1,117	(*)	1	1	1	4	9	1,101
Albania	20							20
Czechoslovakia	186							186
East Germany	17							17
Hungary	17							17
Poland	17					(*)	1	16
Romania	439	(*)	1	1	1		2	435
Soviet Union	10			(*)		4	6	
	426							426
Total, Africa	4,009	258	289	172	151	186	186	2,768
Military supplies and services	392	19	16	11	12	20	19	295
Other [3]	3,617	239	273	161	139	166	167	2,473
Algeria	178	8	1	(*)	(*)	(*)	1	168
Benin	15	1	1	1	1	1	(*)	11
Botswana	20	3	1	2	2	2	3	7
Burundi	9	1	(*)	(*)	(*)	1	(*)	6
Cameroon	27	5	1	1	1	1	1	18
Cape Verde Islands	1	1						
Central African Republic	8	1	(*)	(*)	2	(*)	(*)	5
Chad	25	4	8	1	1	(*)	(*)	10

See footnotes at end of table.

TABLE B-4.—*Summary of U.S. Government net foreign grants, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]—Continued

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Congo (Brazzaville)	10	1	1		(*)	(*)		9
Egypt	341	27	42	4	3	2	2	261
Ethiopia	188	10	18	10	7	7	7	129
Gabon	8	(*)	(*)	(*)	(*)	(*)	(*)	7
Gambia	8	1	1	2	1	1	(*)	2
Ghana	73	7	5	6	5	/	5	36
Guinea	51	1	2	(*)	1	1	1	44
Guinea-Bissau	1	1						
Ivory Coast	23	2	2	1	2	2	1	13
Kenya	79	5	4	5	5	6	5	49
Lesotho	27	4	5	3	3	4	4	5
Liberia	138	6	4	6	7	8	7	99
Libya	206			(*)	(*)	(*)	(*)	206
Madagascar	14	1	(*)	(*)	(*)	1	1	11
Malawi	20	1	(*)	(*)	1	1	1	16
Mali	64	11	22	7	2	4	1	17
Mauritania	20	3	9	4	2	1	(*)	2
Mauritius	14	2	4	1	3	1	1	1
Morocco	376	16	27	13	17	22	22	259
Mozambique	1	1						
Niger	66	10	29	10	2	1	1	12
Nigeria	267	7	8	9	13	19	30	182
Rwanda	15	3	1	(*)	1	1	1	8
Senegal	58	6	6	8	3	4	1	30
Seychelles	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Sierra Leone	47	4	3	2	3	4	2	29
Somalia	73	6	(*)	(*)	(*)	5	4	58
South Africa	−92							−92
Sudan	86	10	3	3	2	(*)	(*)	69
Swaziland	6	1	1	1	1	1	1	1
Tanzania	98	20	9	5	4	4	5	52
Togo	25	3	2	2	1	2	1	14
Tunisia	411	12	10	12	8	12	24	333
Uganda	34	1	1	2	3	3	3	22
Upper Volta	45	6	11	7	4	4	1	13
Zaire	253	3	4	4	4	5	2	232
Zambia	6	(*)	(*)	(*)	(*)	(*)	1	4
Other and unspecified Africa	276	26	26	28	26	29	23	118
Total, Western Hemisphere	5,234	227	200	207	202	239	230	3,931
Military supplies and services	1,324	26	24	25	26	25	25	1,173
Other [3]	3,911	201	176	181	176	214	205	2,757
Antigua	1		(*)		(*)	(*)	(*)	(*)
Argentina	21	(*)	(*)	(*)	(*)	1	1	19
Belize	7	(*)	(*)	(*)	(*)	(*)	(*)	5
Bolivia	330	7	7	6	7	7	6	290
Brazil	598	13	16	23	25	38	42	440
Chile	238	11	6	5	5	10	13	188
Colombia	284	18	18	14	17	24	20	173
Costa Rica	114	3	4	5	6	6	5	85
Cuba	5							5
Dominica	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Dominican Republic	251	10	7	7	9	13	11	193

See footnotes at end of table.

TABLE B-4.—*Summary of U.S. Government net foreign grants, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]—Continued

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Ecuador	136	7	8	9	7	8	6	90
El Salvador	76	3	3	4	4	5	6	51
Grenada	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Guatemala	213	7	6	6	9	8	8	170
Guyana	26	1	1	1	2	2	2	18
Haiti	115	9	5	4	4	4	4	85
Honduras	90	11	6	6	5	5	4	52
Jamaica	48	2	3	3	4	4	3	30
Mexico	159	2	5	1	1	(*)	1	148
Nicaragua	89	4	4	8	4	4	3	62
Panama	136	12	7	7	6	6	6	93
Paraguay	77	3	2	7	5	4	4	51
Peru	226	11	8	12	11	16	15	153
Surinam	5	....	....	(*)	(*)	(*)	(*)	4
Trinidad and Tobago	35	....	(*)	(*)	(*)	(*)	(*)	34
Uruguay	31	1	1	2	3	2	2	20
Venezuela	66	1	1	2	3	3	2	53
Other and unspecified Western Hemisphere	531	61	58	46	37	43	40	245
Total, Asia	67,201	3,798	5,819	3,657	5,547	4,304	3,289	40,787
Military supplies and services	36,875	2,750	2,518	2,490	4,203	3,195	2,435	19,283
Other [3]	30,327	1,048	3,301	1,167	1,345	1,109	853	21,504
Afghanistan	343	11	6	13	21	10	10	273
Bangladesh	311	47	64	122	79	....	....	....
Burma	58	(*)	(*)	(*)	1	1	5	51
Cambodia [4]	638	44	156	99	62	20	(*)	257
China (Taiwan)	1,901	(*)	(*)	4	10	6	3	1,879
Hong Kong	43	(*)	(*)	(*)	(*)	(*)	(*)	42
India	4,553	170	2,138	108	214	177	114	1,633
Indonesia	412	15	26	14	18	13	18	307
Iran	460	1	1	1	2	1	1	452
Iraq	31	....	....	(*)	(*)	1	(*)	29
Israel	1,073	423	98	115	62	6	5	365
Japan and Ryukyu Islands	2,634	−2	−2	−2	−1	8	15	2,619
Jordan	847	67	45	54	74	39	7	560
Korea	4,478	4	14	14	41	48	81	4,276
Laos [4]	906	14	36	54	48	56	53	644
Lebanon	108	1	16	3	2	1	(*)	84
Macao	5	(*)	....	(*)	(*)	(*)	(*)	5
Malaysia	55	2	4	4	3	4	4	35
Nepal	184	8	6	12	13	9	10	126
Pakistan	1,958	24	24	31	15	73	32	1,760
Philippines	1,243	39	38	37	30	16	16	1,066
Saudi Arabia	31	....	(*)	(*)	(*)	(*)	(*)	31
Singapore	2	(*)	(*)	(*)	(*)	(*)	1	1
Sri Lanka (Ceylon)	104	6	5	2	2	6	3	80
Syria	34	(*)	....	(*)	(*)	(*)	(*)	33
Thailand	558	12	12	20	23	30	37	424
Vietnam [4]	6,731	134	585	444	523	547	415	4,084
Yemen (Aden)	3	1	1	1	(*)	(*)	(*)	(*)
Yemen (Sana)	63	6	8	2	(*)	(*)	3	45
Asian Development Bank	1	....	....	....	....	(*)	1	(*)
Other and unspecified Asia	559	22	20	16	104	36	20	341

See footnotes at end of table.

TABLE B-4.—*Summary of U.S. Government net foreign grants, July 1, 1945, to Dec. 31, 1975, by area, type, and country* [1]—Continued

[In millions of dollars and equivalents]

Area, type, and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Total, Oceania (other than military) [3]	619	81	76	66	58	54	49	234
Australia	−7							−7
Fiji	6	1	1	1	1	1	(*)	1
New Zealand	2							2
Solomon Islands	2	(*)	(*)	(*)	(*)	(*)	(*)	1
Tonga Islands	5	(*)	1	1	(*)	(*)	(*)	2
Trust Territory of the Pacific Islands	607	79	73	64	57	53	48	233
Western Samoa	5	1	1	1	(*)	(*)	(*)	2
Other and unspecified Oceania	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Canada (military supplies and services)	9							9
Other international organizations and unspecified, all areas	7,331	647	701	454	536	484	436	4,072
Military supplies and services	443	6	6	3	5	6	4	414
Other [3]	6,888	641	696	452	531	478	432	3,658

*Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Military grant aid is shown by area only.

[2] Includes contributions to the multilateral-construction program of the North Atlantic Treaty Organization and contributions to mutual special weapons projects.

[3] Includes development assistance, technical assistance, and relief.

[4] Separate detail data for Cambodia, Laos, and Vietnam became available during 1954. For earlier periods data for Indochina are included in "Unspecified Asia."

NOTE.—Net grants have not been adjusted for $3,682,-954,000, representing settlements for postwar relief and other grants under agreements; see footnote 4 to table B-1 for additional details.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-5.—*Summary of U.S. Government net foreign credits, July 1, 1945, to Dec. 31, 1975, by area and country* [1]

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years						July 1, 1945, to Dec. 31, 1969
		1975	1974	1973	1972	1971	1970	
Total, all areas	32,618	2,848	–348	1,690	1,484	1,845	1,278	23,820
Total, Europe	6,969	400	220	564	174	–39	–173	5,823
Total, Western Europe	6,570	429	303	179	77	–57	–188	5,828
Austria	42	–2	–2	–2	(*)	9	–6	46
Belgium and Luxembourg	91	18	15	3	–6	–8	4	65
Cyprus	1	(*)	(*)	–1	–1	(*)	3	1
Denmark	69	15	10	24	–1	–5	–1	27
Finland	30	7	(*)	–6	–2	(*)	–8	39
France	–38	–15	–11	12	32	7	–27	–35
Germany	–886	33	46	8	3	6	–16	–965
Greece	403	112	65	43	–9	–11	(*)	202
Iceland	25	3	–3	–3	–2	–2	–2	34
Ireland	61	–18	–15	–10	–5	–20	23	106
Italy	223	–13	–8	11	–15	–7	–8	264
Malta	1	1	(*)	–1	(*)	1	...	...
Netherlands	98	56	34	52	38	2	...	–83
Norway	286	92	95	38	42	6	–2	14
Portugal	117	15	7	11	16	–6	–34	110
Spain	821	91	89	103	–16	–18	1	571
Sweden	17	4	6	–1	–3	–1	2	10
Switzerland	78	28	14	24	12	...	...	...
Turkey	1,616	68	114	52	143	94	77	1,067
United Kingdom	2,564	–89	–162	–132	–208	–138	–142	3,434
Yugoslavia	780	34	–27	–42	56	26	–25	757
European Atomic Energy Community	44	–6	–5	–1	2	(*)	–27	81
European Coal and Steel Community	25	–6	–5	–5	–5	–5	–5	56
Other and unspecified Western Europe	102	1	48	2	5	14	5	26
Total, other Europe	399	–29	–83	385	97	18	15	–5
Czechoslovakia	5	...	...	...	...	...	...	5
Hungary	(*)	–1	–1	1	(*)	–1	–1	3
Poland	157	37	–4	27	6	10	–1	83
Romania	82	20	27	–1	–10	18	27	...
Soviet Union	154	–86	–104	359	102	–10	–10	–96
Total, Africa	2,874	200	227	128	116	291	123	1,790
Algeria	220	33	114	50	2	12	–1	9
Angola	6	(*)	–1	1	(*)	–1	(*)	7
Benin	4	1	2	(*)	(*)	(*)	(*)	(*)
Botswana	15	4	3	6	2	...	...	...
Cameroon	38	(*)	(*)	3	12	5	10	10
Central African Republic	3	1	(*)	1	1	...	...	...
Egypt	624	13	–8	–21	–9	98	–1	551
Ethiopia	105	19	8	8	8	14	2	47
Gabon	9	3	3	2	...	...	...	...
Ghana	190	–1	–4	(*)	12	13	–5	175
Guinea	71	9	6	12	7	10	6	21
Ivory Coast	49	–1	1	14	6	4	11	13
Kenya	37	3	6	1	1	13	(*)	13
Liberia	102	–7	–7	–10	–5	–4	–7	142
Madagascar	6	1	(*)	(*)	(*)	1	1	2
Malawi	15	4	4	(*)	2	2	3	(*)
Mali	3	(*)	(*)	1	(*)	(*)	1	1

See footnotes at end of table.

TABLE B-5.—*Summary of U.S. Government net foreign credits, July 1, 1945, to Dec. 31, 1975, by area and country*[1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Mauritania	1	(*)	1	...	...	...	...	...
Morocco	452	−9	3	5	3	46	46	358
Niger	3	(*)	(*)	(*)	(*)	(*)	1	1
Nigeria	102	(*)	2	15	16	29	6	33
Senegal	5	2	2	(*)	(*)	...	(*)	1
Sierra Leone	12	(*)	(*)	(*)	(*)	(*)	(*)	12
Somalia	16	(*)	(*)	1	3	2	1	9
South Africa	(*)	(*)	...	...	...	...	−2	2
Sudan	48	4	5	14	8	−1	−1	19
Swaziland	2	(*)	(*)	1	1	...	...	...
Tanzania	61	17	2	3	5	7	4	23
Togo	2	(*)	2	...	(*)	1	...	...
Tunisia	304	−4	4	−2	25	26	32	223
Uganda	11	(*)	(*)	(*)	1	2	2	7
Zaire	292	93	60	7	16	8	9	98
Zambia	30	5	9	8	(*)	5	−1	4
East African Common Services Organization	2	(*)	(*)	(*)	(*)	(*)	(*)	2
Other and unspecified Africa	36	8	7	8	−1	(*)	5	8
Total, Western Hemisphere	7,543	572	538	287	257	166	331	5,392
Antigua	1	(*)	...	...	(*)	(*)	(*)	1
Argentina	349	−4	−4	−11	4	21	19	324
Bahamas	29	21	−1	−2	−3	−11	−3	27
Bermuda	18	−5	−2	11	13	...	...	...
Bolivia	260	3	20	4	31	12	21	169
Brazil	2,335	179	248	56	28	61	52	1,712
Cayman Islands	12	2	10	...	...	...	...	...
Chile	1,165	117	78	23	10	−26	43	920
Colombia	912	18	27	81	48	59	98	582
Costa Rica	85	6	5	5	5	3	2	58
Cuba	36	...	...	...	...	...	...	36
Dominican Republic	262	25	2	13	16	8	23	175
Ecuador	110	−1	−1	1	1	2	1	106
El Salvador	68	3	1	5	5	2	4	49
Guatemala	86	13	11	8	9	3	3	39
Guyana	53	15	4	2	4	7	4	16
Haiti	24	2	−2	−1	−1	−1	(*)	26
Honduras	69	12	7	3	5	3	5	34
Jamaica	89	23	19	15	4	11	4	13
Mexico	548	68	90	−6	−12	−19	−2	428
Netherlands Antilles	3	...	3	...	(*)	(*)	(*)	...
Nicaragua	115	9	14	12	1	8	18	52
Panama	178	11	22	35	14	8	9	79
Paraguay	57	3	5	1	2	7	2	37
Peru	265	38	−28	31	37	(*)	−2	188
Surinam	4	1	(*)	(*)	(*)	(*)	(*)	5
Trinidad and Tobago	21	(*)	6	1	2	−1	−2	15
Uruguay	100	−1	(*)	3	16	5	7	68
Venezuela	194	−20	−14	−19	(*)	−22	14	254
Central American Bank for Economic Integration	127	14	12	14	15	23	11	38
Central American Monetary Stabilization Fund	10	10	...	...	...	...	...	...

See footnotes at end of table.

TABLE B–5.—*Summary of U.S. Government net foreign credits, July 1, 1945, to Dec. 31, 1975, by area and country* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years						July 1, 1945, to Dec. 31, 1969
		1975	1974	1973	1972	1971	1970	
Caribbean Development Bank	8	5	2	1				
Other and unspecified Western Hemisphere	−48	1	2	3	(*)	3	(*)	−58
Total, Asia	14,501	1,630	−1,368	699	876	1,369	989	10,306
Afghanistan	90	6	4	17	1	10	−7	59
Bangladesh	389	333	41	15				
Brunei	20		(*)	4	3	12		
Burma	47	−2	−1	(*)	2	2	2	44
Cambodia	207	34	133	31	9			
China (Taiwan)	731	191	119	36	21	7	14	344
Hong Kong	35	19	13		3			(*)
India	3,995	79	−2,114	−36	45	382	374	5,266
Indonesia	1,337	149	99	147	141	121	172	509
Iran	935	−104	36	220	70	195	57	460
Iraq	8	−2	−2	−2	−2	−1	−2	18
Israel	1,941	379	101	123	188	379	83	689
Japan and Ryukyu Islands	−166	12	4	−227	−57	−69	−54	225
Jordan	89	−5	12	11	33	9	8	21
Korea	1,395	309	50	201	200	145	106	383
Kuwait		−5	−10	−10	−10			35
Lebanon	61	36	5	1	3	−3	7	12
Malaysia	60	1	15	−9	12	−5	−6	50
Nepal	3	(*)	(*)	(*)	(*)	1	(*)	3
Pakistan	2,542	103	95	105	130	151	203	1,756
Philippines	375	37	5	34	41	38	48	172
Saudi Arabia	2	−11	−21	−17	−4	−13	−16	83
Singapore	75	15	26	34	1	(*)		
Sri Lanka (Ceylon)	133	14	−3	22	18	9	8	65
Syria	30	18	(*)	(*)	(*)	(*)	(*)	13
Thailand	85	−2	7	1	−5	(*)	−3	87
Vietnam	96	26	16	−1	31	−2	−3	30
Other and unspecified Asia	−14	(*)			2			−16
Total, Oceania	413	7	−46	−48	39	36	4	421
Australia	285	−23	−62	−59	39	26	−17	380
New Caledonia	1							1
New Zealand	97	30	16	8	−5	(*)	8	40
Papua New Guinea	30			3	5	10	13	
Other and unspecified Oceania	(*)							(*)
Canada	266	45	87	65	28	28	9	3
Other international organizations: United Nations	52	−6	−5	−5	−5	−5	−5	84

*Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

NOTE.—New credits do not include $3,682,954,000 representing settlements for postwar relief and other grants under agreements, including that for the reversion of the Ryukyu Islands to Japan. New grants have not been adjusted for any part of these settlements. For major countries, these amounted to: Germany, $1,000,000,000; Soviet Union, $838,595,000; Japan, $810,000,000; United Kingdom, $562,447,000; France, $353,300,000; and Netherlands, $47,160,000. Although settlements have not been reached with China, for statistical convenience the amount of postwar lend-lease credits ($50,345,000) is included in the total of "settlements" noted here, and thus reported in grants rather than credits.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-5A.—*Summary of U.S. Government foreign credits utilized, July 1, 1945, to Dec. 31, 1975, by area and country* [1]

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Total, all areas	64,887	5,293	4,468	4,252	3,534	3,935	2,991	40,414
Total, Europe	19,545	1,206	1,047	1,243	831	569	429	14,220
Total, Western Europe	18,190	992	889	737	674	507	381	14,011
Austria	161	1	2	(*)	4	16	1	135
Belgium and Luxembourg	348	24	22	11	2	4	12	273
Cyprus	5					1	3	1
Denmark	113	16	13	25		2		57
Finland	191	12	4	2	5	10	1	157
France	2,379	21	20	43	62	34		2,199
Germany	524	51	54	14	15	10	−2	381
Greece	723	139	94	71	18	17	22	362
Iceland	61	6	1	1	1	1	1	50
Ireland	171	−2	3		1	8	25	136
Italy	1,289	25	37	56	40	64	58	1,010
Malta	2	1		(*)	(*)	1		
Netherlands	581	59	36	53	39	2		393
Norway	426	96	98	41	45	9		137
Portugal	249	25	17	21	23	2	4	158
Spain	1,465	150	157	162	68	39	61	829
Sweden	55	6	8	2			3	37
Switzerland	83	31	15	25	12			
Turkey	1,925	106	145	73	170	116	107	1,208
United Kingdom	5,637	94	35	68	36	65	52	5,286
Yugoslavia	1,435	118	74	54	120	83	23	962
European Atomic Energy Community	108	(*)	−2	10	5	7	−1	89
European Coal and Steel Community	100							100
North Atlantic Treaty Organization	9					(*)	(*)	9
Other and unspecified Western Europe	148	10	56	6	8	17	12	39
Total, other Europe	1,355	215	158	506	157	62	48	210
Czechoslovakia	13							13
Hungary	18			1				17
Poland	438	72	41	60	31	34	20	180
Romania	162	35	44	20	8	28	27	
Soviet Union	724	108	73	426	118			
Total, Africa	4,028	397	348	238	212	393	190	2,249
Algeria	240	38	118	53	5	13		12
Angola	11	1	(*)	2	1		(*)	7
Benin	4	1	2	(*)	(*)	(*)	(*)	(*)
Botswana	15	4	3	6	2			
Cameroon	41	1	(*)	3	12	5	10	10
Central African Republic	3	1	(*)	1	1			
Egypt	921	118	25	3	19	140		617
Ethiopia	150	22	12	11	10	16	4	75
Gabon	9	3	3	2				
Ghana	268	6	3	11	22	26	20	180
Guinea	77	11	7	13	7	11	7	22
Ivory Coast	58	2	4	15	7	4	12	15
Kenya	47	5	7	1	2	13	1	19
Liberia	213	6	5	1	6	6	5	184
Libya	7							7
Madagascar	6	1	(*)	(*)	(*)	1	1	2

See footnotes at end of table.

TABLE B–5A.—*Summary of U.S. Government foreign credits utilized, July 1, 1945, to Dec. 31, 1975, by area and country* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years						July 1, 1945, to Dec. 31, 1969
		1975	1974	1973	1972	1971	1970	
Malawi	15	4	4	(*)	2	2	3	(*)
Mali	3	(*)	(*)	1	(*)	(*)	1	1
Mauritania	1		1					
Morocco	628	13	31	38	28	65	56	396
Niger	3	(*)	(*)	(*)	(*)	(*)	1	1
Nigeria	113	3	4	16	16	29	7	38
Senegal	5	2	2	(*)	(*)	(*)	(*)	1
Sierra Leone	15	(*)	(*)		(*)	(*)	1	14
Somalia	17	(*)	(*)	1	3	2	2	9
South Africa	154	(*)						154
Sudan	69	11	13	17	8	(*)		21
Swaziland	2	(*)	(*)	1	1			
Tanzania	64	17	3	4	5	7	4	25
Togo	2		2		(*)	1		
Tunisia	377	7	15	10	34	33	38	241
Uganda	11		(*)	(*)	1	2	2	7
Zaire	319	100	65	11	20	11	11	101
Zambia	49	6	10	9	2	6		17
East African Common Services Organization	3							3
Other and unspecified Africa	108	12	9	10		1	6	72
Total, Western Hemisphere	13,595	1,119	1,202	650	557	522	682	8,864
Antigua	2							2
Argentina	1,056	42	36	29	48	60	70	770
Bahamas	54	23	2					30
Barbados	1			(*)				(*)
Bermuda	28		2	13	13			
Bolivia	308	10	26	9	35	16	26	186
Brazil	3,992	300	351	165	117	160	148	2,751
Cayman Islands	14	4	10					
Chile	2,031	251	370	30	14	23	86	1,257
Colombia	1,332	40	50	102	64	77	113	887
Costa Rica	137	10	9	8	10	7	8	85
Cuba	40							40
Dominican Republic	330	36	15	21	23	14	29	192
Ecuador	211	6	7	10	11	9	8	162
El Salvador	93	6	3	7	7	3	5	61
Guatemala	128	18	16	14	12	6	6	56
Guyana	53	15	4	2	4	7	4	16
Haiti	39	3	(*)	(*)	(*)	(*)	1	34
Honduras	89	16	9	5	6	4	6	42
Jamaica	126	26	22	18	6	12	6	36
Mexico	1,465	122	137	50	35	31	57	1,033
Netherlands Antilles	3		3				(*)	
Nicaragua	152	12	18	15	4	11	20	73
Panama	237	19	27	41	19	14	14	102
Paraguay	88	6	7	3	4	9	4	55
Peru	702	91	23	66	57	12	13	439
Surinam	7	2						5
Trinidad and Tobago	39	2	8	2	3	1	(*)	23
Uruguay	135	3	3	6	19	7	9	87
Venezuela	538	22	27	15	29	10	38	397
Central American Bank for Economic Integration	132	15	13	14	16	24	11	39

See footnotes at end of table.

TABLE B–5A.—*Summary of U.S. Government foreign credits utilized, July 1, 1945, to Dec. 31, 1975, by area and country* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Central American Monetary Stabilization Fund	10	10						
Caribbean Development Bank	8	5	2	1				
Other and unspecified Western Hemisphere	13	1	2	2	(*)	3	(*)	4
Total, Asia	25,793	2,422	1,726	1,931	1,803	2,293	1,590	14,027
Afghanistan	136	10	7	20	5	13	4	76
Bangladesh	389	333	41	15				
Brunei	20		(*)	4	3	12		
Burma	61	(*)	(*)	1	3	2	2	51
Cambodia	286	34	186	55	11			
China (Taiwan)	1,177	233	163	79	59	49	47	548
Hong Kong	37	21	13		3			(*)
India	7,271	190	74	81	145	476	456	5,849
Indonesia	1,748	163	109	159	150	310	186	673
Iran	1,864	20	168	337	173	287	139	739
Iraq	27				(*)	1		26
Israel	2,797	464	188	221	321	455	130	1,018
Japan and Ryukyu Islands	2,780	176	149	217	223	217	161	1,637
Jordan	129	10	18	15	33	11	12	30
Korea	1,790	396	131	264	273	193	131	402
Kuwait	50							50
Lebanon	89	39	9	3	7	2	10	18
Malaysia	132	10	24	3	20	3	2	69
Nepal	4					1	1	3
Pakistan	2,914	159	132	137	168	172	228	1,920
Philippines	838	78	40	100	96	67	64	392
Saudi Arabia	266	(*)	1	2	23	6	7	227
Singapore	76	16	26	34	1	(*)		
Sri Lanka (Ceylon)	159	23	7	25	19	10	8	67
Syria	33	18						15
Thailand	163	4	14	9	2	6	3	126
Vietnam	555	26	225	148	64			91
Other and unspecified Asia	2	(*)			2			
Total, Oceania	1,279	84	45	116	99	130	90	714
Australia	1,053	45	20	96	92	112	63	626
New Caledonia	2							2
New Zealand	193	39	26	17	2	8	15	86
Papua New Guinea	30			3	5	10	13	
Trust Territory of the Pacific Islands	1							1
Canada	506	64	99	74	32	28	10	199
Other international organizations: United Nations	141							141

*Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

NOTE.—New credits do not include $3,682,954,000 representing settlements for postwar relief and other grants under agreements, including that for the reversion of the Ryukyu Islands to Japan. New grants have not been adjusted for any part of these settlements. For major countries, these amounted to: Germany, $1,000,000,000; Soviet Union, $838,595,000; Japan, $810,000,000; United Kingdom, $562,447,000; France, $353,300,000; and Netherlands, $47,160,000. Although settlements have not been reached with China, for statistical convenience the amount of postwar lend-lease credits ($50,345,000) is included in the total of "settlements" noted here, and thus reported in grants rather than credits.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B–5B.—*Summary of U.S. Government foreign credit repayments, July 1, 1945, to Dec. 31, 1975, by area and country* [1]

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Total, all areas	32,270	2,444	4,816	2,562	2,050	2,090	1,713	16,594
Total, Europe	12,576	806	827	679	657	607	602	8,397
Total, Western Europe	11,620	562	587	558	597	564	569	8,183
Austria	119	4	5	2	4	7	7	89
Belgium and Luxembourg	257	6	7	8	8	11	8	208
Cyprus	4	(*)	(*)	1	1	1	(*)	(*)
Denmark	44	1	3	1	1	7	1	30
Finland	161	5	4	8	7	9	9	118
France	2,417	36	31	31	29	28	27	2,234
Germany	1,410	18	8	6	13	4	14	1,346
Greece	321	27	29	28	27	27	22	160
Iceland	36	3	4	3	3	3	3	17
Ireland	111	17	18	10	5	28	2	31
Italy	1,066	39	45	45	55	71	66	746
Malta	1	(*)	(*)	1	(*)	...	...	...
Netherlands	483	3	2	1	(*)	(*)	...	477
Norway	140	4	2	2	2	4	2	123
Portugal	132	10	10	10	7	8	38	48
Spain	644	59	68	58	84	56	60	259
Sweden	39	2	2	3	3	1	1	26
Switzerland	5	3	1	1	...	...	...	...
Turkey	309	38	31	21	27	22	30	140
United Kingdom	3,073	183	196	201	244	203	194	1,852
Yugoslavia	655	83	101	96	64	57	49	205
European Atomic Energy Community	64	6	4	11	3	7	25	9
European Coal and Steel Community	75	6	5	5	5	5	5	44
North Atlantic Treaty Organization	9	...	(*)	...	...	...	...	9
Other and unspecified Western Europe	46	9	8	4	3	3	6	14
Total, other Europe	957	244	241	121	60	44	33	215
Czechoslovakia	8	...	...	...	...	...	...	8
Hungary	18	1	1	(*)	(*)	1	1	14
Poland	280	35	46	33	25	24	22	96
Romania	81	15	17	21	18	9	...	...
Soviet Union	570	193	177	67	16	10	10	96
Total, Africa	1,154	197	121	110	97	103	67	459
Algeria	20	4	4	3	3	1	1	3
Angola	5	1	1	1	1	1	(*)	...
Cameroon	3	1	1	(*)	(*)	...	...	...
Egypt	298	105	33	24	28	41	1	66
Ethiopia	45	3	3	3	3	3	2	28
Ghana	78	8	7	11	10	13	25	6
Guinea	6	2	1	1	(*)	(*)	(*)	1
Ivory Coast	10	3	2	(*)	(*)	(*)	(*)	3
Kenya	10	2	1	(*)	(*)	(*)	(*)	5
Liberia	111	14	11	11	11	10	12	42
Libya	7	...	...	...	...	...	...	7
Morocco	176	22	28	33	25	19	10	38
Nigeria	11	3	1	(*)	1	(*)	(*)	5
Senegal	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Sierra Leone	3	(*)	(*)	(*)	(*)	(*)	1	1

See footnotes at end of table.

TABLE B-5B.—*Summary of U.S. Government foreign credit repayments, July 1, 1945, to Dec. 31, 1975, by area and country* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Somalia	1			(*)			(*)	(*)
South Africa	154						2	152
Sudan	21	7	8	3	(*)	1	1	2
Tanzania	3	1	(*)	(*)	(*)	(*)	(*)	2
Tunisia	72	11	11	11	9	7	6	17
Zaire	27	6	6	4	3	3	2	3
Zambia	19	1	1	1	1	1	1	13
East African Common Services Organization	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Other and unspecified Africa	73	4	1	1	1	1	1	63
Total, Western Hemisphere	6,052	547	664	363	300	356	351	3,471
Antigua	1	(*)			(*)	(*)	(*)	(*)
Argentina	708	47	39	41	43	39	51	447
Bahamas	25	2	2	2	3	11	3	2
Bermuda	10	5	3	2				
Bolivia	49	7	7	5	4	4	5	17
Brazil	1,657	121	103	110	89	100	96	1,039
Cayman Islands	2	2						
Chile	866	134	292	6	4	49	43	337
Colombia	420	22	23	21	16	18	15	305
Costa Rica	52	3	4	4	4	4	6	28
Cuba	3							3
Dominican Republic	68	11	13	9	7	6	7	16
Ecuador	101	8	8	8	9	7	6	56
El Salvador	26	3	3	3	2	1	1	13
Guatemala	42	5	5	6	4	3	3	16
Haiti	15	1	2	1	1	1	1	8
Honduras	21	4	2	2	1	1	1	9
Jamaica	36	3	2	3	2	2	1	23
Mexico	917	54	47	56	46	49	59	606
Nicaragua	38	3	3	3	3	2	2	21
Panama	59	8	6	7	5	7	4	22
Paraguay	32	3	2	2	2	2	2	18
Peru	437	53	51	35	20	12	15	252
Surinam	3	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Trinidad and Tobago	18	2	1	1	1	2	2	8
Uruguay	35	4	4	3	2	2	2	19
Venezuela	344	42	41	33	29	32	23	143
Central American Bank for Economic Integration	5	1	1	1	1	1	(*)	1
Other and unspecified Western Hemisphere	62	(*)	(*)	(*)	(*)	(*)		62
Total, Asia	11,292	792	3,094	1,232	927	924	601	3,721
Afghanistan	45	4	4	3	4	3	11	17
Burma	13	2	1	1	1	1	1	7
Cambodia	79	(*)	53	24	1			
China (Taiwan)	447	43	43	43	38	42	33	204
Hong Kong	1	1	(*)					(*)
India	3,277	111	2,188	117	100	95	83	583
Indonesia	411	13	10	12	9	189	14	164
Iran	929	124	132	117	104	92	82	279
Iraq	19	2	2	2	2	2	2	8
Israel	855	85	87	98	132	76	48	330
Japan and Ryukyu Islands	2,945	164	144	444	280	286	215	1,412

See footnotes at end of table.

TABLE B–5B.—*Summary of U.S. Government foreign credit repayments, July 1, 1945, to Dec. 31, 1975, by area and country* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
Jordan	40	14	6	5	(*)	2	4	9
Korea	395	87	81	63	73	48	25	19
Kuwait	50	5	10	10	10	...	...	15
Lebanon	29	3	4	3	4	5	3	7
Malaysia	72	9	9	12	8	8	8	19
Nepal	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Pakistan	373	56	37	32	38	22	25	163
Philippines	463	41	35	67	55	29	16	220
Saudi Arabia	264	11	21	19	27	19	23	144
Singapore	1	1	(*)	(*)	(*)	(*)	...	...
Sri Lanka (Ceylon)	26	9	10	3	1	(*)	1	2
Syria	3	(*)	(*)	(*)	(*)	(*)	(*)	2
Thailand	78	6	7	7	6	6	5	39
Vietnam	459	(*)	209	150	33	2	3	61
Other and unspecified Asia	16	(*)	...	...	...	...	...	16
Total, Oceania	866	77	91	164	60	93	86	293
Australia	769	68	81	155	53	85	79	247
New Zealand	96	9	10	9	8	8	7	46
Trust Territory of the Pacific Islands	1	...	...	...	...	...	...	1
Other and unspecified Oceania	(*)	...	...	...	...	...	...	(*)
Canada	241	19	13	8	4	1	(*)	196
Other international organizations: United Nations	89	6	5	5	5	5	5	57

*Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Repayments include collections for sale of all or fractional parts of notes and other evidences of indebtedness to foreign participants either in the country of borrower or a 3d country. Such collections are recorded in this *Report* against the country of the borrower.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

Table B-6.—*Summary of U.S. Government foreign assistance through net accumulation of foreign currency claims, July 1, 1945, to Dec. 31, 1975, by area and country* [1]

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969 [2]
Total, all areas	2,052	29	−247	−49	−213	−246	−101	2,880
Total, Europe	622	−25	−22	−19	−31	−25	−39	782
Total, Western Europe	314	4	(*)	−2	−3	−1	−20	336
Belgium and Luxembourg	(*)	....	....	....	....	−1	1	(*)
Finland	7	(*)	(*)	(*)	(*)	(*)	(*)	7
France	2	....	....	....	....	(*)	(*)	2
Germany	−1	(*)	(*)	(*)	(*)	(*)	(*)	−1
Spain	84	(*)	(*)	(*)	−1	(*)	(*)	85
Switzerland	(*)	(*)	(*)	−1	(*)	1	(*)	(*)
Turkey	63	(*)	1	(*)	−1	(*)	−8	71
United Kingdom	(*)	(*)	(*)	(*)	(*)	(*)	−1	1
Yugoslavia	159	4	(*)	−2	−1	−1	−11	171
Other Western Europe	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Other Europe: Poland	308	−28	−21	−17	−28	−24	−20	446
Total, Africa	416	50	−9	−11	−2	−3	−15	406
Egypt	355	47	−7	−4	1	5	−1	315
Ghana	3	(*)	(*)	(*)	−2	−5	2	9
Guinea	4	−1	−2	−4	−4	−5	−3	24
Morocco	4	1	−1	−4	1	2	−4	9
Senegal	(*)	(*)	(*)	(*)	(*)	(*)	(*)	1
Sudan	4	−1	(*)	−1	(*)	(*)	−1	7
Tunisia	22	4	3	2	3	(*)	−7	18
Zaire	23	(*)	(*)	(*)	(*)	(*)	(*)	23
Other Africa	(*)	(*)	(*)	(*)	(*)	(*)	(*)	1
Total, Western Hemisphere	262	(*)	−1	−4	(*)	−1	−5	272
Argentina	6	(*)	(*)	(*)	(*)	(*)	(*)	6
Bolivia	1	(*)	(*)	(*)	(*)	−1	−4	6
Brazil	194	(*)	−1	(*)	(*)	(*)	−1	196
Chile	23	(*)	(*)	(*)	(*)	(*)	(*)	23
Colombia	16	(*)	(*)	(*)	(*)	(*)	(*)	16
Ecuador	1	(*)	(*)	(*)	(*)	(*)	(*)	1
Paraguay	(*)	(*)	(*)	−3	(*)	(*)	(*)	4
Peru	2	(*)	(*)	(*)	(*)	(*)	(*)	2
Uruguay	18	(*)	(*)	(*)	....	(*)	(*)	18
Other Western Hemisphere	(*)	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Total, Asia	752	3	−216	−16	−180	−218	−42	1,420
Afghanistan	4	(*)	(*)	(*)	(*)	(*)	−1	4
Burma	8	1	1	(*)	(*)	(*)	−5	12
Cambodia	3	(*)	−1	−1	1	4	....	(*)
China (Taiwan)	2	(*)	(*)	−2	−4	1	−2	9
Hong Kong	1	(*)	....	....	....	....	....	(*)
India	438	−5	−205	−5	−146	−89	−54	943
Indonesia	222	(*)	(*)	(*)	(*)	(*)	−1	224
Iran	−1	(*)	(*)	(*)	(*)	−1	(*)	(*)
Israel	35	(*)	(*)	(*)	−1	−8	−3	47
Japan	(*)	(*)	....	(*)	−2	1	−1	1
Jordan	(*)	(*)	(*)	(*)	(*)	−1	−1	2
Korea	18	(*)	−1	−1	−21	1	12	28
Nepal	5	1	4	(*)	(*)	(*)	(*)	(*)

See footnotes at end of table.

TABLE B-6.—*Summary of U.S. Government foreign assistance through net accumulation of foreign currency claims, July 1, 1945, to Dec. 31, 1975, by area and country* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969 [2]
Pakistan	138	7	4	−2	9	−8	8	120
Philippines	10	(*)	(*)	(*)	(*)	(*)	(*)	11
Sri Lanka (Ceylon)	3	(*)	(*)	(*)	(*)	−1	(*)	3
Syria	8	....	....	....	−2	....	....	10
Vietnam	−143	(*)	−16	−6	−15	−118	6	5
Other Asia	(*)	(*)	(*)	(*)	(*)	(*)	....	(*)
Oceania: Australia	(*)	....	....	....	....	....	....	(*)
Canada	(*)	....	....	....	....	(*)	....	(*)

*Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

[2] Activity under these programs did not begin until calendar year 1953.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-7.—*Summary of U.S. Government foreign credits, July 1, 1940, to Dec. 31, 1975, by major program* [1]

[In millions of dollars and equivalents]

[Numbers in brackets indicate table in which data are available by geographical area and country; † indicates that such data are also shown for 6 recent years.]

	Total	By major program: Under Export-Import Bank Act [2]	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Loans of foreign currencies: To private enterprises	Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Gross authorizations by U.S. Government agencies	90,104	[3, 4] 38,355	25,018	5,806	474	6,428	6,296	7,726
Deduct—								
Authorizations assumed by participants:								
Other U.S. Government agencies [5]	671	62	609					
Other	563	563						
Deduct—								
Reimbursements by participants: [6]								
Other U.S. Government agencies	16	16						
Private entities	481	481						
Foreign governments and official institutions [7]	152	152						
Add—Export-Import Bank credits utilized for refunding indebtedness outstanding on Export-Import Bank loans	731	731						
Equals—Adjusted authorizations	88,952	37,812	24,409	5,806	474	6,428	6,296	7,726
Deduct—								
Authorizations canceled, expired, and otherwise terminated without utilization	10,414	6,631	1,458	629	52	713	607	324
Disbursements by private enterprises at Export-Import Bank risk [8]	495	495						
Credits unutilized as of December 31, 1975 [B-9]	8,395	[4] 5,342	2,780	2	3	268		(*)
Equals—Credits utilized	69,647	25,344	20,170	5,176	418	5,448	5,689	7,402
During World War II	1,077	[2] 311					349	417
During postwar period [9] [B-5A†, B-10]	[10] 68,570	25,033	20,170	5,176	418	5,448	[10] 5,341	6,984
Add—Increased valuation of lend-lease silver credits repaid by cash collections	9						9	
Deduct—								
Adjustment to outstanding principal for discount allowance for extraordinary prepayment	32			25			7	
Principal charged off as uncollectable [11]	25	4	14		5			3
Add—Net adjustment to outstanding principal by revaluation of indebtedness repayable in foreign currencies (exchange risk (loss (—))) [11]	—1,398		—32	—1,269	—89		—8	
Deduct—Principal collections	32,612	15,719	4,858	2,464	218	1,250	4,163	3,940
During World War II	342	[2] 176					46	120
During postwar period [9] [B-5B†, B-10]	32,270	[7] 15,543	4,858	2,464	218	1,250	4,116	3,820

TABLE B-7.—*Summary of U.S. Government foreign credits, July 1, 1940, to Dec. 31, 1975, by major program* [1]—Continued

	Total	By major program: Under Export-Import Bank Act [2]	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	To private enterprises	Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Equals—Principal outstanding indebtedness as of December 31, 1975 [B-8] ...	35,589	9,621	15,267	1,418	105	4,198	1,520	3,459
Memorandum—								
Principal outstanding as of June 30, 1945 ...	735	135	...	...	...	...	303	297
Interest collected ...	13,149	5,272	3,209	1,177	133	435	1,133	1,790
During World War II ...	70	[2] 36	...	...	...	...	...	33
During postwar period [9] [B-10, B-11†] ...	13,080	5,236	3,209	1,177	133	435	1,133	1,757
Total principal and interest collected ...	45,761	20,991	8,067	3,641	352	1,685	5,295	5,730

• Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

[2] Includes Export-Import Bank activity during the period from Feb. 12, 1934, through June 30, 1940, as follows: Gross authorized, $436,132,000; terminated, $118,201,000; disbursed by others at Export-Import Bank risk, $66,701,000; utilized, $92,935,000; principal collected, $42,006,000; interest and commissions collected, $5,760,000; outstanding on Government disbursments, as of June 30, 1940, $50,929,000; outstanding at Government risk on others' disbursements as of June 30, 1940, $47,529,000.

[3] Gross authorizations as published by the Export-Import Bank total $38,709,685,000. This amount has been adjusted for credit extended to domestic institutions ($200,053,000), credits purchased from and resold to the Defense Department ($155,237,000), and certain minor modifications to achieve consistency over longer periods in Export-Import Bank reporting.

[4] Does not include unutilized portions, if any, of Export-Import Bank refunding credits available for additional refunding under commitments.

[5] The participation of any other Government agency in loans of the Export-Import Bank is subtracted as an adjustment entry from gross authorizations and from disbursements of the Bank, but is included against such other agency in this presentation (except that participation of one Government agency in financing loans of the Bank in the amount of $7,000,000 and participations in individual loans sold to the Secretary of Treasury Deposit Accounts related to foreign government defense procurement in the United States in the amount of $312,055,000 are recorded as Bank transactions, only). Conversely, the participation of the Bank in credits extended by the Defense Department is subtracted as an adjustment entry from gross authorizations and from disbursements of that Department under the Foreign Assistance Act programs, but is included against the Bank in this presentation.

[6] "Reimbursements by participants" represent recovery of U.S. Government funds (1) through sale to private U.S. entities of fractions of notes acquired previously for the Export-Import Bank's portfolio, or (2) where the Bank acts as an agent for the participating private, domestic or foreign entity, or a foreign government or official institution, in *current* disbursement of a loan without guaranteeing repayment by the borrower. These reimbursements are subtracted from gross authorizations of the Bank as an adjustment entry, and are also incorporated as negative disbursements of the Bank in this presentation.

[7] Reimbursements through sales to foreign participants, either in the country of the borrower or a 3d country, are not included as reimbursement by participants, but are included as principal collections, in the amount of $915,530,000. The Export-Import Bank has a contingent liability totaling $373,489,000 (not including guaranteed interest thereon) to repurchase note fractions sold to foreign participants and included in principal collections in this *Report*.

[8] U.S. commercial banks and other private U.S. entities participated in certain loans of the Export-Import Bank under agreements which specified that at the option of either party the Bank would reimburse the private participant for the unpaid principal amount of the loan with accrued interest, or which specified that the Bank would reimburse the disbursing participant to the extent of all or part of the principal in default. Disbursements by the participants under these guarantees were charged to the amounts authorized and thus decreased the amount reported for utilized. In event of repurchase by the Bank, the amounts were incorporated—in the period of the repurchase—as positive entries for utilized and in "Disbursements by private enterprises at Export-Import Bank risk" as negative entries. Nothing remained outstanding at Bank risk on the participations after Oct. 31, 1963.

[9] Includes transactions for lend-lease and prior grants converted into credits occurring after Sept. 2, 1945 (V-J Day); postwar period for data for all other categories begins with July 1, 1945.

[10] Includes $3,682,954,000 representing settlements for postwar relief and other grants under agreements providing for the repayment of principal. This amount is not included in statistics on new credits in tables B-1, B-2, and B-5A. See footnote 4 to table B-1.

[11] Table B-10 includes data by geographical area and country for exchange adjustments and principal charged off as uncollectable, added together.

Source: Compiled by the Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-8.—*Outstanding indebtedness of foreign countries on U.S. Government credits, as of Dec. 31, 1975, by area, country, and major program* [1]

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enterprises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Total, all areas	35,589	9,621	15,267	1,418	105	4,198	1,520	3,459
Total, Europe	9,865	3,075	1,917	465	13	216	1,226	2,954
Total, Western Europe	8,624	2,768	1,889	465	13	216	546	2,728
Austria	42	20	1	21				
Belgium and Luxembourg	91	76	15				(*)	
Cyprus	1			1				
Denmark	69	54	15					
Finland	54	37		16			1	
France	313	168	1				144	
Germany	114	112					2	
Greece	399	11	321	45	1	11		11
Iceland	20	7	6	3		4		
Ireland	61	14	46					
Italy	223	223					(*)	
Liechtenstein	2	2						
Malta	1		1					(*)
Netherlands	182	182						
Norway	292	283	9					
Portugal	117	80	11	2		23		
Spain	821	625	22	174	(*)			
Sweden	17	17						
Switzerland	78	78						
Turkey	1,543	121	1,162	80	12	55		114
United Kingdom	3,442	293	192				399	2,558
Yugoslavia	575	266	61	123		123	(*)	2
European Atomic Energy Community	44	(*)						43
European Coal and Steel Community	25		25					
Unspecified Western Europe	100	100						
Total, other Europe	1,241	307	27				680	226
Czechoslovakia	5						5	
Hungary	(*)							(*)
Poland	161	92	27				1	41
Romania	82	41						41
Soviet Union	993	174					674	145
Total, Africa	2,776	658	1,241	437	6	369	16	49
Algeria	220	214				6		
Angola	6	6						(*)
Benin	4	(*)	4					
Botswana	15		15					
Cameroon	38	13	25					
Central African Republic	3	3						
Egypt	520	24	79	264		111		42
Ethiopia	109	7	98	(*)		3		

See footnotes at end of table.

TABLE B–8.—*Outstanding indebtedness of foreign countries on U.S. Government credits, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign govern-ments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enter-prises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settle-ments for grants and war accounts	Other credits
Gabon	9	9						
Ghana	187	18	120	17	2	30		
Guinea	71	7	7	22		36		
Ivory Coast	49	38	7	1		2		
Kenya	37	12	20			5		
Liberia	106	26	61			3	16	
Madagascar	6		6					
Malawi	15		15					
Mali	3		3	(*)				
Mauritania	1	1						
Morocco	465	21	324	48	2	71		
Niger	3		3					
Nigeria	102	24	79					
Senegal	5	4		1				
Sierra Leone	12	10				2		
Somalia	16		16			1		
Sudan	40	15	12	5		5		4
Swaziland	2		2					
Tanzania	60		53			7		
Togo	2	2						
Tunisia	317	4	176	73	1	64		
Uganda	11		11					
Zaire	276	157	86	6	1	24		2
Zambia	30	29	1					
East African Common Services Organization	2					2		
Other Africa	(*)		(*)					(*)
Unspecified Africa	34	16	17					
Total, Western Hemisphere	7,390	2,354	4,450	73	2	402	8	100
Antigua	1	1						
Argentina	334	206	127	(*)				(*)
Bahamas	29	29						
Bermuda	18	18						
Bolivia	248	30	174	12	1	32		(*)
Brazil	2,172	775	1,288	16		92	1	(*)
Cayman Islands	12	12						
Chile	1,147	304	648	22		137		35
Colombia	892	48	801	4	(*)	38	(*)	(*)
Costa Rica	91	11	79					(*)
Cuba	36	36						
Dominican Republic	264	47	163			46		8
Ecuador	115	12	88	(*)		14		(*)
El Salvador	68	2	67					
Guatemala	86	6	79		(*)			1
Guyana	53	4	48			1		
Haiti	32	23	6			2	(*)	(*)
Honduras	69	7	58			5		(*)

See footnotes at end of table.

TABLE B-8.—*Outstanding indebtedness of foreign countries on U.S. Government credits, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enterprises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Jamaica	89	63	25			1		
Mexico	545	451	88	6				(*)
Netherlands Antilles	3	3						
Nicaragua	118	4	112					1
Panama	178	66	112					
Paraguay	62	6	42	5	1	8		
Peru	261	58	141	8	(*)			54
Surinam	4	4	1					
Trinidad and Tobago	21	21						
Uruguay	85	2	57	(*)		25		(*)
Venezuela	196	103	92					
Central American Bank for Economic Integration	127	(*)	127					
Central American Monetary Stabilization Fund	10		10					
Caribbean Development Bank	8		8					
Other Western Hemisphere	1	(*)	(*)					
Unspecified Western Hemisphere	16		9				7	
Total, Asia	14,813	2,841	7,660	443	85	3,211	271	303
Afghanistan	89	2	67	2		19		
Bangladesh	390		52		1	337		
Brunei	20	20						
Burma	47	2	30	16				
Cambodia	207					207		
China (Taiwan)	831	412	243	27	(*)	19	116	14
Hong Kong	35	35						
India	3,625	141	2,864		74	532		13
Indonesia	1,321	209	406			673	35	−1
Iran	946	734	116	27		40	23	6
Iraq	8	3				5		
Israel	1,880	116	1,411	108	1	244		
Japan	608	522				4	74	8
Jordan	89	16	45	4		23		1
Korea	1,391	212	493		2	469	23	191
Lebanon	61	50				10		
Malaysia	60	33	27					
Nepal	3		(*)	2				
Pakistan	2,396	78	1,667	227	6	401		19
Philippines	363	134	106	6	(*)	70	(*)	48
Saudi Arabia	21	12	9					
Singapore	75	75						
Sri Lanka (Ceylon)	131	3	21	10	1	91		5
Syria	31		(*)	13		18		
Thailand	85	30	41	2		12		
Vietnam	96		59			37		
Other Asia	(*)		(*)					
Unspecified Asia	2		2					

See footnotes at end of table.

TABLE B–8.—*Outstanding indebtedness of foreign countries on U.S. Government credits, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enterprises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Total, Oceania	421	421						
Australia	293	293						
New Zealand	97	97						
Papua New Guinea	31	31						
Canada	272	272						
Other international organizations: United Nations	52							52

*Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Includes only indebtedness arising from credits extended since 1934. Includes estimates for the U.S. dollar equivalent of indebtedness denominated in other than dollars. See table B–8A for indebtedness repayable in U.S. dollars (totaling $32,599,369,000) and table B–8B for indebtedness repayable at the option of the debtor in foreign currencies, goods, or services (totaling $2,989,361,000).

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-8A.—*Outstanding indebtedness of foreign countries on U.S. Government credits, repayable in U.S. dollars, as of Dec. 31, 1975, by area, country, and major program* [1]

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies to foreign governments	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Total, all areas	32,599	9,621	13,831	58	4,198	1,434	3,458
Total, Europe	9,131	3,075	1,648	12	216	1,226	2,954
Total, Western Europe	7,891	2,768	1,621	12	216	546	2,728
Austria	21	20	1				
Belgium and Luxembourg	91	76	15			(*)	
Denmark	69	54	15				
Finland	50	37		12		1	
France	312	168	(*)			144	
Germany	114	112				2	
Greece	307	11	275		11		10
Iceland	16	7	5		4		
Ireland	61	14	46				
Italy	223	223				(*)	
Liechtenstein	2	2					
Malta	1		1				(*)
Netherlands	182	182					
Norway	292	283	9				
Portugal	115	80	11		23		
Spain	628	625	3		(*)		
Sweden	17	17					
Switzerland	78	78					
Turkey	1,305	121	1,016		55		114
United Kingdom	3,442	293	192			399	2,558
Yugoslavia	398	266	7		123		2
European Atomic Energy Community	44	(*)					43
European Coal and Steel Community	25		25				
Unspecified Western Europe	100	100					
Total, other Europe	1,241	307	27			680	226
Czechoslovakia	5					5	
Hungary	(*)						(*)
Poland	161	92	27			1	41
Romania	82	41					41
Soviet Union	993	174				674	145
Total, Africa	2,121	658	1,028		369	16	49
Algeria	220	214			6		
Angola	6	6					(*)
Benin	4	(*)	4				
Botswana	15		15				
Cameroon	38	13	25				
Central African Republic	3	3					
Egypt	250	24	73		111		42
Ethiopia	99	7	89		3		
Gabon	9	9					
Ghana	168	18	120		30		
Guinea	49	7	7		36		

See footnotes at end of table.

TABLE B–8A.—*Outstanding indebtedness of foreign countries on U.S. Government credits, repayable in U.S. dollars, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies to foreign governments	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Ivory Coast	47	38	7		2		
Kenya	37	12	20		5		
Liberia	106	26	61		3	16	
Madagascar	6		6				
Malawi	15		15				
Mali	3		3				
Mauritania	1	1					
Morocco	241	21	150		71		
Niger	3		3				
Nigeria	102	24	79				
Senegal	4	4					
Sierra Leone	12	10			2		
Somalia	15		14		1		
Sudan	35	15	12		5		4
Swaziland	2		2				
Tanzania	60		53		7		
Togo	2	2					
Tunisia	225	4	157		64		
Uganda	11		11				
Zaire	270	157	86		24		2
Zambia	30	29	1				
East African Common Services Organization	2				2		
Other Africa	(*)		(*)				(*)
Unspecified Africa	32	16	16				
Total, Western Hemisphere	6,785	2,354	3,912	11	402	8	99
Antigua	1	1					
Argentina	290	206	84				
Bahamas	29	29					
Bermuda	18	18					
Bolivia	219	30	158		32		
Brazil	2,072	775	1,204		92	1	
Cayman Islands	12	12					
Chile	1,084	304	602	5	137		35
Colombia	836	48	750		38		
Costa Rica	73	11	61				
Cuba	36	36					
Dominican Republic	255	47	154		46		8
Ecuador	89	12	63		14		(*)
El Salvador	47	2	46				
Guatemala	71	6	64		(*)		(*)
Guyana	53	4	48		1		
Haiti	27	23	1		2	(*)	(*)
Honduras	58	7	47		5		
Jamaica	89	63	25		1		
Mexico	513	451	56	6			
Netherlands Antilles	3	3					
Nicaragua	98	4	93				1

See footnotes at end of table.

TABLE B-8A.—*Outstanding indebtedness of foreign countries on U.S. Government credits, repayable in U.S. dollars, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies to foreign governments	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Panama	160	66	93				
Paraguay	48	6	34		8		
Peru	193	58	81		(*)		54
Surinam	4	4	1				
Trinidad and Tobago	21	21					
Uruguay	76	2	48		25		
Venezuela	148	103	45				
Central American Bank for Economic Integration	127	(*)	127				
Central American Monetary Stabilization Fund	10		10				
Caribbean Development Bank	8		8				
Other Western Hemisphere	1	(*)	(*)				
Unspecified Western Hemisphere	16		9			7	
Total, Asia	13,817	2,841	7,242	35	3,211	184	303
Afghanistan	88	2	67		19		
Bangladesh	389		52		337		
Brunei	20	20					
Burma	5	2		4			
Cambodia	207				207		
China (Taiwan)	664	412	149		19	71	14
Hong Kong	35	35					
India	3,546	141	2,859		532		13
Indonesia	1,321	209	406		673	35	—1
Iran	921	734	116	2	40	23	6
Iraq	8	3			5		
Israel	1,763	116	1,373	30	244		
Japan	589	522			4	55	8
Jordan	86	16	45		23		1
Korea	1,365	212	492		469		191
Lebanon	61	50			10		
Malaysia	60	33	27				
Pakistan	1,990	78	1,493		401		19
Philippines	332	134	80		70		48
Saudi Arabia	21	12	9				
Singapore	75	75					
Sri Lanka (Ceylon)	117	3	18		91		5
Syria	18		(*)		18		
Thailand	54	30	12		12		
Vietnam	78		41		37		
Other Asia	(*)		(*)				
Unspecified Asia	2		2				
Total, Oceania	421	421					
Australia	293	293					
New Zealand	97	97					
Papua New Guinea	31	31					

See footnotes at end of table.

TABLE B–8A.—*Outstanding indebtedness of foreign countries on U.S. Government credits, repayable in U.S. dollars, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies to foreign governments	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Canada	272	272					
Other international organizations: United Nations	52						52

*Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Includes outstanding indebtedness repayable in U.S. dollars. (The U.S. Government may exercise its option to request foreign currencies, goods, or services on many of these credits.) Includes $1,753,000 denominated in foreign currencies (without maintenance of dollar value) and repayable in U.S. dollars.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-8B.—*Outstanding indebtedness of foreign countries on U.S. Government credits, repayable in foreign currencies, as of Dec. 31, 1975, by area, country, and major program* [1]

[In millions of dollars and equivalents]

Area and country	Total	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies — To foreign governments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies — To private enterprises	Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
Total, all areas	2,989	1,436	1,359	105	87	1
Total, Europe	733	268	452	13	(*)	(*)
Total, Western Europe	733	268	452	13	(*)	(*)
Austria	21		21			
Cyprus	1		1			
Finland	4		4			
France	1	1				
Greece	92	46	45	1		(*)
Iceland	4	1	3			
Portugal	2		2			
Spain	193	19	174			
Turkey	238	146	80	12		
United Kingdom	1	1				
Yugoslavia	177	54	123		(*)	
Total, Africa	655	212	437	6		
Egypt	271	7	264			
Ethiopia	10	10	(*)			
Ghana	19		17	2		
Guinea	22		22			
Ivory Coast	1		1			
Morocco	223	174	48	2		
Senegal	1		1			
Somalia	1	1				
Sudan	5		5			
Tunisia	92	19	73	1		
Zaire	6		6	1		
Other Africa	(*)		(*)			
Unspecified Africa	2	2				
Total, Western Hemisphere	604	538	63	2	(*)	1
Argentina	43	43	(*)			(*)
Bolivia	28	16	12	1		(*)
Brazil	100	83	16			(*)
Chile	63	46	17			(*)
Colombia	56	51	4	(*)	(*)	(*)
Costa Rica	18	18				(*)
Dominican Republic	9	9				
Ecuador	26	25	(*)			(*)
El Salvador	21	21				
Guatemala	15	15				(*)
Haiti	5	5				
Honduras	11	11				(*)
Mexico	32	32				(*)
Nicaragua	20	20				
Panama	18	18				
Paraguay	13	8	5	1		
Peru	68	59	8	(*)		

See footnotes at end of table.

TABLE B–8B.—*Outstanding indebtedness of foreign countries on U.S. Government credits, repayable in foreign currencies, as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies		Lend-lease, surplus property, and settlements for grants and war accounts	Other credits
			To foreign governments	To private enterprises		
Uruguay	9	9	(*)			(*)
Venezuela	48	48				
Total, Asia	997	417	408	85	87	
Afghanistan	2		2			
Bangladesh	1			1		
Burma	42	30	12			
China (Taiwan)	167	95	27	(*)	45	
India	79	5		74		
Iran	25		25			
Israel	117	38	78	1		
Japan	19				19	
Jordan	4		4			
Korea	26	1		2	23	
Nepal	2	(*)	2			
Pakistan	406	174	227	6		
Philippines	31	25	6	(*)	(*)	
Sri Lanka (Ceylon)	14	3	10	1		
Syria	13	(*)	13			
Thailand	31	29	2			
Vietnam	18	18				

*Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Includes the estimated U.S. dollar equivalent of the outstanding indebtedness repayable at the option of the debtor in foreign currencies, goods, or services.

Part of this outstanding indebtedness is denominated in U.S. dollars, but repayable in foreign currencies with maintenance of U.S. dollar value; the remainder is denominated in foreign currencies and repayable without maintenance of U.S. dollar value, as follows (in millions of dollars and equivalents):

	Repayable in foreign currencies	
	With maintenance of U.S. dollar value	Without maintenance of U.S. dollar value
Total	1,846	1,143
Under Foreign Assistance Act and related programs	1,390	47
Under Agricultural Trade Development and Assistance Act:		
To foreign governments	387	972
To private enterprises		105
Lend-lease, surplus property, and settlements for grants and war accounts	68	19
Other	1	

Additional details are available in the semiannual report, "Foreign Credits by the United States Government."

Source: Compiled by the Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-9.—*Unutilized balances of U.S. Government foreign credits as of Dec. 31, 1975, by area, country, and major program* [1]

[In millions of dollars and equivalents]

Area and country	Total [2]	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enterprises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Other
Total, all areas	8,395	5,342	2,780	2	3	268	(*)
Total, Europe	1,852	1,791	61				
Total, Western Europe	1,492	1,431	61				
Austria	6	6	(*)				
Belgium and Luxembourg	3	3					
Denmark	1	1					
Finland	26	26					
France	33	33	(*)				
Germany	28	28					
Greece	15	5	11				
Ireland	10	10					
Italy	29	29					
Malta	4		4				
Netherlands	26	26					
Norway	104	104					
Portugal	20	6	14				
Spain	591	591					
Sweden	22	22					
Switzerland	19	19					
Turkey	106	76	30				
United Kingdom	130	130					
Yugoslavia	277	276	1				
Unspecified Western Europe	43	43					
Total, other Europe	360	360					
Poland	47	47					
Romania	19	19					
Soviet Union	294	294					
Total, Africa	1,085	409	563	2		111	
Algeria	195	195					
Angola	2	2					
Benin	20	(*)	20				
Botswana	9		9				
Cameroon	1	1					
Cape Verde Islands	3		3				
Egypt	413	25	279			109	
Ethiopia	54		54				
Gabon	19	14	5				
Ghana	25	7	18				
Guinea	3			1		2	
Ivory Coast	35	35					
Kenya	31	1	30				
Liberia	30	4	26				
Malawi	16		16				
Mali	10		10				
Mauritania	4	4					

See footnotes at end of table.

TABLE B-9.—*Unutilized balances of U.S. Government foreign credits as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total [2]	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign governments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enterprises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Other
Morocco	37	12	24				
Mozambique	2	2					
Nigeria	1		1				
Rwanda	1		1				
Senegal	1	1		(*)			
Sierra Leone	9	9					
Sudan	3	(*)	3				
Swaziland	1		1				
Tanzania	10		10			(*)	
Tunisia	9		9				
Zaire	95	67	28				
Zambia	32	28	4				
Other Africa	1	(*)	1				
Unspecified Africa	14		14				
Total, Western Hemisphere	2,124	1,220	891			13	(*)
Argentina	144	104	40				(*)
Bahamas	1	1					
Barbados	2	2					
Bolivia	86	5	81				
Brazil	620	489	131				
Cayman Islands	2	2					
Chile	74	18	49			7	
Colombia	87	25	62				
Costa Rica	20	3	17				
Dominican Republic	58	37	17				
Ecuador	19	7	13			5	
El Salvador	19	6	12				
Guatemala	50	15	35				
Guyana	19	3	16				
Haiti	8		8				
Honduras	44	5	38			(*)	
Jamaica	26	9	17			(*)	
Mexico	359	359				1	
Netherlands Antilles	16	16					
Nicaragua	68	1	67				
Panama	79	32	47				
Paraguay	11		11				
Peru	115	40	75				
Trinidad and Tobago	6	6					
Uruguay	22	(*)	22				
Venezuela	47	34	12				
Central American Bank for Economic Integration	52		52				
Caribbean Development Bank	25		25				
Andean Development Corporation	15		15				
Other Western Hemisphere	(*)	(*)					
Unspecified Western Hemisphere	32		32				

See footnotes at end of table.

TABLE B-9.—*Unutilized balances of U.S. Government foreign credits as of Dec. 31, 1975, by area, country, and major program* [1]—Continued

[In millions of dollars and equivalents]

Area and country	Total [2]	Under Export-Import Bank Act	Under Foreign Assistance Act and related programs	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To foreign govern-ments	Under Agricultural Trade Development and Assistance Act: Loans of foreign currencies: To private enter-prises	Under Agricultural Trade Development and Assistance Act: Long-term dollar credits	Other
Total, Asia	3,230	1,819	1,264	(*)	3	144	
Afghanistan	16		16				
Bangladesh	63		37			26	
Cambodia	4					4	
China (Taiwan)	613	517	96				
Hong Kong	10	10					
India	34	6	15			13	
Indonesia	451	256	189			6	
Iran	5	3	2				
Israel	544	158	384			3	
Japan	239	239					
Jordan	78		72			6	
Korea	361	265	90			5	
Laos	5		5				
Lebanon	32	12	20				
Malaysia	39	29	9				
Pakistan	130	(*)	120		3	7	
Philippines	399	304	94			(*)	
Saudi Arabia	7	1	6				
Singapore	17	17					
Sri Lanka (Ceylon)	9		7			3	
Syria	81		78			3	
Thailand	19	1	17				
Vietnam	74		7			67	
Yemen (Aden)	1		1				
Other Asia	(*)		(*)	(*)			
Total, Oceania	54	53	1				
Australia	30	29	1				
New Zealand	24	24					
Canada	51	51					

*Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

[2] Excludes uncommitted lending authorities.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

Table B–10.—*Summary of U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, and principal and interest due and unpaid for 90 days or more, as of Dec. 31, 1975, by program, and by area and country* [1]

[In millions of dollars and equivalents]

Major program, and area and country	July 1, 1945, to Dec. 31, 1975				Due and unpaid 90 days or more [2]	
	Utilized [3]	Repaid	Exchange adjustments (+ or −) and principal charged off as uncollectable (−) [4]	Interest and commissions collected	Principal	Interest [5]
Total, all programs and all areas	68,570	32,270	−1,423	13,080	187	136
By Credit Program						
Under Export-Import Bank Act	25,033	15,543	−4	5,236	40	35
Under Foreign Assistance Act and related programs:						
Country program loans	15,850	3,426	−34	2,804	46	39
Social Progress Trust Fund	713	207		116		
Financing of military purchases	3,345	1,075		245	7	1
Deficiency and basic materials development	147	133	−11	35	1	(*)
Investment incentive credits	116	16		9	(*)	(*)
Under Agricultural Trade Development and Assistance Act:						
Currency loans to:						
Foreign governments	5,176	2,464	−1,269	1,177	6	5
Private enterprises	418	218	−94	133	5	3
Long-term dollar credits	5,448	1,250		435	3	4
Lend-lease, surplus property, and settlements for grants and war accounts	5,341	4,116	−8	1,133	77	48
Other credits	6,984	3,820	−3	1,757	2	(*)
By Area and Country						
Total, Europe	22,354	12,576	−292	5,574	5	3
Total, Western Europe	20,160	11,619	−292	5,303	(*)	(*)
Austria	161	119		37		
Belgium and Luxembourg	348	257		89		
Cyprus	5	4	(*)	1		
Denmark	113	44		29		
Finland	191	161	−1	83		
France	2,732	2,417	−3	828		
Germany	1,524	1,410	(*)	277		
Greece	723	321	−4	149	(*)	
Iceland	61	36	−4	17		
Ireland	171	111		75		
Italy	1,289	1,066	(*)	224		
Liechtenstein	2	1		(*)		
Malta	2	1		(*)		
Netherlands	628	483		129		
Norway	432	140	(*)	61		
Portugal	249	132	−1	71		
Spain	1,465	644	(*)	363		
Sweden	55	39		10		
Switzerland	83	5		8		
Turkey	1,925	309	−73	365	(*)	
United Kingdom	6,200	3,073	−1	2,048		
Yugoslavia	1,436	655	−205	326	(*)	(*)
European Atomic Energy Community	108	64		31		

See footnotes at end of table.

TABLE B-10.—*Summary of U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, and principal and interest due and unpaid for 90 days or more, as of Dec. 31, 1975, by program, and by area and country* [1]—Continued

[In millions of dollars and equivalents]

Major program, and area and country	July 1, 1945, to Dec. 31, 1975				Due and unpaid 90 days or more [2]	
	Utilized [3]	Repaid	Exchange adjustments (+ or −) and principal charged off as uncollectable (−) [4]	Interest and commissions collected	Principal	Interest [5]
By Area and Country—Continued						
European Coal and Steel Community	100	75		56		
North Atlantic Treaty Organization	9	9				
Unspecified Western Europe	146	45		25		
Total, other Europe	2,194	957	(*)	271	5	3
Czechoslovakia	13	8		1	5	3
Hungary	18	18		6		
Poland	438	280	(*)	95		
Romania	162	81		15		
Soviet Union	1,563	570		153		
Total, Africa	4,029	1,154	−107	736	11	5
Algeria	240	20	(*)	26		
Angola	11	5	(*)	3		
Benin	4	(*)		(*)		(*)
Botswana	15			(*)		
Cameroon	41	3		5		
Central African Republic	3			(*)		(*)
Egypt	921	298	−103	172	2	(*)
Ethiopia	150	45	(*)	23		
Gabon	9			1		
Ghana	268	78	−3	68		
Guinea	77	6	(*)	6	2	1
Ivory Coast	58	10	(*)	11	(*)	
Kenya	47	10	(*)	6		
Liberia	213	111	(*)	59	(*)	
Libya	7	7		1		
Madagascar	6			(*)		
Malawi	15			1		
Mali	3	(*)	(*)	(*)		
Mauritania	1	(*)		(*)		
Morocco	628	176	13	172		
Niger	3	(*)		(*)		
Nigeria	113	11		12		
Senegal	5	1	(*)	(*)	(*)	
Sierra Leone	15	3		3	(*)	(*)
Somalia	17	1		1	2	1
South Africa	154	154	(*)	40		
Sudan	69	21	−7	9	1	(*)
Swaziland	2			(*)		
Tanzania	64	3	−1	5		
Togo	2	(*)		(*)		
Tunisia	377	72	13	61	(*)	(*)
Uganda	11	(*)		1	(*)	(*)
Zaire	319	27	−16	23	2	3
Zambia	49	19		6		

See footnotes at end of table.

TABLE B-10.—*Summary of U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, and principal and interest due and unpaid for 90 days or more, as of Dec. 31, 1975, by program, and by area and country* [1]—Continued

[In millions of dollars and equivalents]

Major program, and area and country	July 1, 1945, to Dec. 31, 1975: Utilized [3]	Repaid	Exchange adjustments (+ or −) and principal charged off as uncollectable (−) [4]	Interest and commissions collected	Due and unpaid 90 days or more [2]: Principal	Interest [5]
BY AREA AND COUNTRY—Continued						
East African Common Services Organization	3	1		(*)		
Other Africa	1	(*)		(*)		
Unspecified Africa	108	72	−2	22	1	(*)
Total, Western Hemisphere	13,597	6,052	−279	2,601	46	33
Antigua	2	1		1		
Argentina	1,056	708	−15	276	(*)	(*)
Bahamas	54	25		8		
Barbados	1	(*)		(*)		
Bermuda	28	10		4		
Bolivia	308	49	−14	46	2	(*)
Brazil	3,992	1,657	−182	838	(*)	(*)
Cayman Islands	14	2		1		
Chile	2,031	866	−18	356		
Colombia	1,332	420	−26	189	3	(*)
Costa Rica	137	52	(*)	26	(*)	(*)
Cuba	40	3		9	36	31
Dominican Republic	330	68		36	2	1
Ecuador	211	101	(*)	45	(*)	
El Salvador	93	26		13	(*)	
Guatemala	128	42		17		
Guyana	53	(*)	(*)	3		
Haiti	39	15	(*)	13	(*)	(*)
Honduras	89	21		10	(*)	(*)
Jamaica	126	36	(*)	17		
Mexico	1,465	917	−3	330	1	(*)
Netherlands Antilles	3	(*)		(*)		
Nicaragua	152	38		17		
Panama	237	59		37	(*)	
Paraguay	88	32		20	1	1
Peru	702	437	−4	128	(*)	(*)
Surinam	7	3		1		
Trinidad and Tobago	39	18		9		
Uruguay	135	35	−14	21		
Venezuela	538	344	(*)	110		
Central American Bank for Economic Integration	132	5		8		
Central American Monetary Stabilization Fund	10					
Caribbean Development Bank	8			(*)		
Other Western Hemisphere	(*)	(*)	(*)	(*)		
Unspecified Western Hemisphere	16	62		12		
Total, Asia	26,664	11,292	−745	3,890	125	95
Afghanistan	136	45	−1	34		
Bangladesh	389	(*)	(*)	2	(*)	(*)
Bahrain		16		1		
Brunei	20			5		

See footnotes at end of table.

Table B-10.—*Summary of U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, and principal and interest due and unpaid for 90 days or more, as of Dec. 31, 1975, by program, and by area and country* [1]—Continued

[In millions of dollars and equivalents]

Major program, and area and country	July 1, 1945, to Dec. 31, 1975				Due and unpaid 90 days or more [2]	
	Utilized [3]	Repaid	Exchange adjustments (+ or −) and principal charged off as uncollectable (−) [4]	Interest and commissions collected	Principal	Interest [5]
By Area and Country—Continued						
Burma	61	13		23		
Cambodia	286	79		1		3
China (Taiwan)	1,228	447	1	181	49	34
Hong Kong	37	1		2		
India	7,273	3,277	−465	1,293	4	2
Indonesia	1,748	411	−15	199	(*)	(*)
Iran	1,873	929	2	355	23	11
Iraq	27	19		5	(*)	
Israel	2,797	855	−61	445	3	1
Japan and Ryukyu Islands	3,590	2,945	−4	452		
Jordan	129	40	(*)	19	3	1
Korea	1,790	395	−4	145		(*)
Kuwait	50	50		13		
Lebanon	89	29		8	(*)	(*)
Malaysia	132	72		21		
Nepal	4	1	−1	1		
Pakistan	2,914	373	−185	393	39	36
Philippines	838	463	−11	147		
Saudi Arabia	266	264		37		
Singapore	76	1		7		
Sri Lanka (Ceylon)	159	26	−2	22		
Syria	33	3	1	2	1	4
Thailand	163	78		51	1	1
Vietnam	555	459	(*)	26	1	1
Other Asia	(*)			(*)		(*)
Unspecified Asia	2			(*)		
Total, Oceania	1,280	866	−1	218		
Australia	1,054	769		184		
New Caledonia	2	(*)	−1	(*)		
New Zealand	193	96		26		
Papua New Guinea	31			8		
Trust Territory of the Pacific Islands	1	1		(*)		
Canada	506	241		46		
Other international organizations: United Nations	141	89		14		

*Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note. Excludes transactions on credits originating before 1940, with the exception that transactions on all Export-Import Bank credits (since 1934) are included.

[2] As reported by the operating agencies. Does not include principal or interest for which revised, deferred terms have been agreed upon (for example, interest and principal on the British loan and lend-lease, surplus property, and settlements for grants due from the United Kingdom in 1956, 1957, 1964, 1965, and 1968, and deferred by agreement of Mar. 6, 1957, and Public Law 85–21, until Dec. 31, 2002, or later). Does not include amounts reported charged off as uncollectable. Excludes $46,923,000 principal and interest due from the Republic of China for assets left on the Asian continent, for which Export-Import Bank by agreement with that Government has deferred from pressing.

[3] Includes $3,682,954,000 representing settlements for postwar relief and other grants under agreements providing for repayment of principal. This amount is not included in statistics on new credits in tables B–1, B–2, and B–5A.

[4] "Exchange adjustments" total $1,398,410,000 and generally occur on loans extended in foreign currency with

repayment scheduled in foreign currency when devaluation occurs in the exchange rate after disbursement. Some adjustments result from currency appreciation and increase the value of the indebtedness outstanding. If the credit was denominated in dollars and a rate specified in the credit agreement, although different from the current exchange value, was used for collections no adjustment has been computed. All principal charged off as uncollectable ($24,987,000) has been on loans to nongovernmental foreign entities. Amounts of accrued interest charged off as uncollectable are not included in this table. Adjustments in the value of lend-lease silver returned, in the amount of $8,564,000, are not included in "exchange adjustments." Adjustments to outstanding principal for discount allowed for extraordinary prepayments are not included in "exchange adjustments."

[5] Amounts reported are known to be understated; in several instances agencies have stopped reporting accruals of interest when credits have gone into default.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B-11.—*Summary of interest and commissions collected on U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, by program, and by area and country* [1]

[In millions of dollars and equivalents]

Major program, and area and country	Total (30½ years)	Calendar years						July 1, 1945, to Dec. 31, 1969
		1975	1974	1973	1972	1971	1970	
Total, all programs and all areas	13,080	1,110	1,055	918	828	829	758	7,582
BY CREDIT PROGRAM								
Under Export-Import Bank Act	5,236	530	452	352	313	321	310	2,957
Under Foreign Assistance Act and related programs:								
Country program loans	2,804	214	199	195	198	191	184	1,623
Social Progress Trust Fund	116	13	13	13	13	12	12	41
Financing of military purchases	245	81	61	42	30	20	4	7
Deficiency and basic materials development	35	(*)	(*)	1	(*)	(*)	(*)	33
Investment incentive credits	9	5	3	1	(*)	(*)	....	(*)
Under Agricultural Trade Development and Assistance Act:								
Currency loans to:								
Foreign governments	1,177	44	67	96	98	107	98	667
Private enterprises	133	8	11	11	10	11	12	71
Long-term dollar credits	435	73	80	77	49	49	33	74
Lend-lease, surplus property, and settlements for grants and war accounts	1,133	17	18	17	20	33	25	1,003
Other credits	1,757	126	150	113	95	86	79	1,107
BY AREA AND COUNTRY								
Total, Europe	5,574	346	321	278	245	248	252	3,885
Total, Western Europe	5,303	303	277	262	237	241	246	3,737
Austria	37	1	2	3	2	2	4	23
Belgium and Luxembourg	89	4	3	2	2	3	2	73
Cyprus	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Denmark	29	3	3	1	(*)	1	(*)	20
Finland	83	3	2	3	3	2	3	68
France	828	13	13	13	9	7	7	766
Germany	277	6	3	2	2	1	1	262
Greece	149	16	11	8	8	9	9	88
Iceland	17	1	1	1	1	1	1	12
Ireland	75	3	4	4	3	5	2	53
Italy	224	15	15	14	14	15	15	135
Netherlands	129	9	7	4	1	(*)	(*)	108
Norway	61	12	8	4	2	1	1	35
Portugal	71	5	5	4	4	4	5	44
Spain	363	42	34	31	26	27	26	177
Sweden	10	1	1	1	1	1	1	6
Switzerland	8	4	2	1	(*)	(*)	(*)	(*)
Turkey	365	37	33	30	28	24	28	185
United Kingdom	2,048	90	94	97	102	109	112	1,443
Yugoslavia	326	29	26	30	20	23	21	175
European Atomic Energy Community	31	2	3	2	2	3	4	15
European Coal and Steel Community	56	1	1	2	2	2	2	46
Other and unspecified Western Europe	26	6	5	3	3	2	2	4
Total, other Europe	271	43	44	16	8	8	5	148
Czechoslovakia	1	....	....	....	....	....	....	1
Hungary	6	(*)	(*)	(*)	(*)	(*)	(*)	6
Poland	95	8	8	6	5	5	4	62

See footnotes at end of table.

TABLE B-11.—*Summary of interest and commissions collected on U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, by program, and by area and country* [1]—Continued

[In millions of dollars and equivalents]

Major program, and area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
BY AREA AND COUNTRY—Continued								
Romania	15	6	2	3	3	2		(*)
Soviet Union	153	29	34	8	(*)	1	2	79
Total, Africa	736	88	84	68	62	69	42	322
Algeria	26	13	7	3	1	1	(*)	1
Angola	3	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Cameroon	5	1	1	1	(*)	(*)	(*)	(*)
Egypt	172	14	20	12	14	26	4	81
Ethiopia	23	2	2	2	2	2	1	11
Gabon	1	(*)	(*)					
Ghana	68	6	7	7	7	7	8	24
Guinea	6	1	1	2	(*)	(*)	(*)	1
Ivory Coast	11	3	3	2	1	1	1	1
Kenya	6	1	1	1	1	(*)	(*)	1
Liberia	59	3	3	4	4	4	5	36
Libya	1							1
Malawi	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Morocco	172	17	18	17	17	15	13	75
Nigeria	12	3	3	1	2	1	(*)	3
Sierra Leone	3	(*)	(*)	(*)	(*)	(*)	(*)	2
Somalia	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
South Africa	40						(*)	40
Sudan	9	2	1	1	(*)	1	(*)	4
Tanzania	5	1	1	1	1	(*)	(*)	2
Tunisia	61	8	8	9	6	6	5	18
Uganda	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Zaire	23	7	5	4	3	2	1	1
Zambia	6	2	1	1	1	(*)	(*)	1
Other and unspecified Africa	24	2	2	1	1	1	(*)	17
Total, Western Hemisphere	2,601	241	248	155	142	157	160	1,497
Antigua	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Argentina	276	16	14	17	16	15	14	184
Bahamas	8	1	1	1	1	1	2	3
Bermuda	4	1	1	1	(*)			(*)
Bolivia	46	5	5	4	4	4	3	22
Brazil	838	69	51	52	46	45	45	529
Cayman Islands	1	1	(*)					(*)
Chile	356	46	88	2	2	21	27	170
Colombia	189	18	16	16	14	13	12	100
Costa Rica	26	2	2	2	2	2	2	15
Cuba	9						(*)	8
Dominican Republic	36	5	6	4	4	3	3	9
Ecuador	45	3	3	3	3	3	3	27
El Salvador	13	1	1	1	1	1	1	6
Guatemala	17	2	2	2	2	2	2	7
Guyana	3	1	1	1	(*)	(*)	(*)	(*)
Haiti	13	(*)	(*)	(*)	(*)	(*)	(*)	11
Honduras	10	1	1	1	1	1	1	5
Jamaica	17	4	2	2	1	1	1	6
Mexico	330	28	20	20	19	20	21	201
Nicaragua	17	2	2	2	2	1	1	7

See footnotes at end of table.

TABLE B-11.—*Summary of interest and commissions collected on U.S. Government foreign credits, July 1, 1945, to Dec. 31, 1975, by program, and by area and country* [1]—Continued

[In millions of dollars and equivalents]

Major program, and area and country	Total (30½ years)	Calendar years 1975	1974	1973	1972	1971	1970	July 1, 1945, to Dec. 31, 1969
BY AREA AND COUNTRY—Continued								
Panama	37	6	5	3	3	2	2	15
Paraguay	20	2	1	1	2	1	1	12
Peru	128	10	10	9	6	5	6	82
Surinam	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Trinidad and Tobago	9	1	1	1	1	1	1	4
Uruguay	21	2	2	2	2	1	1	10
Venezuela	110	9	9	8	10	11	10	51
Central American Bank for Economic Integration	8	2	1	1	1	1	(*)	1
Other and unspecified Western Hemisphere	12	1	(*)	(*)	(*)	(*)	(*)	11
Total, Asia	3,890	394	365	373	353	324	277	1,805
Afghanistan	34	1	2	1	1	1	1	25
Bangladesh	2	1	(*)	...	...	...	...	...
Brunei	5	1	1	1	1	(*)	(*)	...
Burma	23	2	2	2	2	2	2	12
Cambodia	1	(*)	1	(*)	...	...	...	(*)
China (Taiwan)	181	30	20	16	13	11	12	79
Hong Kong	2	1	1	(*)	(*)	...	...	(*)
India	1,293	73	83	124	112	117	108	677
Indonesia	199	26	21	18	14	16	12	93
Iran	355	61	58	48	40	28	23	97
Iraq	5	(*)	(*)	(*)	(*)	1	1	3
Israel	445	58	53	48	44	30	24	188
Japan and Ryukyu Islands	452	31	28	26	28	32	28	280
Jordan	19	4	4	3	2	2	1	3
Korea	145	36	31	22	16	21	8	12
Kuwait	13	(*)	1	1	2	2	2	4
Lebanon	8	1	1	1	1	1	1	2
Malaysia	21	3	3	3	2	2	3	5
Nepal	1	(*)	(*)	(*)	(*)	(*)	(*)	(*)
Pakistan	393	35	25	31	50	30	37	186
Philippines	147	16	17	14	13	16	7	65
Saudi Arabia	37	1	3	5	4	7	3	15
Singapore	7	4	2	1	(*)	...	...	(*)
Sri Lanka (Ceylon)	22	4	5	3	2	2	2	5
Syria	2	...	(*)	(*)	(*)	(*)	(*)	2
Thailand	51	3	3	4	3	4	3	31
Vietnam	26	(*)	1	1	1	1	1	21
Other and unspecified Asia	1	(*)	(*)	(*)	(*)	(*)	...	1
Total, Oceania	218	25	26	37	21	27	24	56
Australia	184	20	21	33	17	24	22	48
New Zealand	26	4	3	3	3	3	3	8
Papua New Guinea	8	2	2	2	1	1	(*)	(*)
Other and unspecified Oceania	(*)	...	...	...	(*)	(*)	...	(*)
Canada	46	15	10	6	3	2	1	9
Other international organizations: United Nations	14	1	1	1	1	1	1	8

* Less than $500,000.

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

TABLE B–12.—*Summary of U.S. Government foreign assistance through net accumulation of foreign currency claims, July 1, 1953, to Dec. 31,1975, by program, and by area and country* [3]

[In millions of dollars and equivalents]

Program, and area and country	Net assistance	Currency claims acquired: Through farm products sales	Currency claims acquired: From 2d-stage operations [2]	Inter-country and inter-program transfers	Currency disbursed for—Economic assistance in recipient's currency: Grants	Currency disbursed for—Economic assistance in recipient's currency: Credits	Currency disbursed for—All other
Total, all programs and all areas	2,052	14,996	4,202	...	7,420	5,863	3,863
BY (FARM PRODUCTS SALES) PROGRAM							
Under Agricultural Trade Development and Assistance Act	2,021	12,922	4,202	11	6,164	5,566	3,383
Under Mutual Security Acts	31	2,031	...	...	1,255	297	447
Under Commodity Credit Corporation Charter Act	(*)	43	...	–11	...	...	33
BY AREA AND COUNTRY							
Total, Europe	622	3,699	374	65	782	1,089	1,645
Total, Western Europe	314	3,179	374	77	782	1,089	1,445
Austria	(*)	56	...	(*)	1	25	30
Belgium and Luxembourg	(*)	2	...	11	...	...	13
Cyprus	(*)	2	(*)	(*)	...	1	2
Denmark	...	4	...	1	...	2	3
Finland	7	48	9	(*)	...	23	27
France	2	251	6	–8	40	6	200
Germany	[3] –1	163	...	31	96	...	99
Greece	(*)	202	49	–2	59	99	92
Iceland	(*)	16	5	(*)	(*)	12	9
Italy	(*)	237	5	–1	24	96	120
Netherlands	(*)	9	...	10	7	...	12
Norway	(*)	2	...	1	1	...	3
Portugal	(*)	7	...	1	...	3	5
Spain	84	710	61	–1	158	222	305
Sweden	(*)	...	...	3	...	...	3
Switzerland	(*)	...	...	24	...	...	24
Turkey	63	526	150	–7	94	238	274
United Kingdom	(*)	216	...	19	96	...	139
Yugoslavia	159	729	89	–7	208	360	84
Other Western Europe	(*)	...	...	(*)	...	...	(*)
Other Europe: Poland	308	520	...	–11	...	...	201
Total, Africa	416	1,178	274	3	98	692	250
Egypt	355	809	200	–15	51	459	129
Ethiopia	(*)	3	(*)	1	3	(*)	1
Ghana	3	37	8	(*)	2	23	17
Guinea	4	32	2	–1	1	23	5
Ivory Coast	(*)	3	(*)	...	...	2	2
Libya	(*)	...	...	1	1	...	(*)
Mali	(*)	1	(*)	...	...	(*)	(*)
Morocco	4	88	23	9	(*)	80	36
Nigeria	(*)	...	...	1	(*)	...	1
Senegal	(*)	3	(*)	(*)	(*)	1	2
Somalia	(*)	...	(*)	1	1	...	(*)
South Africa	(*)	(*)	...	1	...	...	1
Sudan	4	26	2	1	4	8	14
Tunisia	22	90	32	3	20	72	12
Zaire	23	85	5	(*)	15	24	28

See footnotes at end of table.

TABLE B-12.—*Summary of U.S. Government foreign assistance through net accumulation of foreign currency claims, July 1, 1953, to Dec. 31, 1975, by program, and by area and country* [3]—Continued

[In millions of dollars and equivalents]

Program, and area and country	Net assistance	Currency claims acquired: Through farm products sales	Currency claims acquired: From 2d-stage operations [2]	Inter-country and inter-program transfers	Currency disbursed for—Economic assistance in recipient's currency: Grants	Currency disbursed for—Economic assistance in recipient's currency: Credits	Currency disbursed for—All other
BY AREA AND COUNTRY—Continued							
Other Africa	(*)	(*)	(*)	1	(*)		1
Total, Western Hemisphere	262	898	95	(*)	86	410	236
Argentina	6	31	1	1		15	11
Bolivia	1	68	13	(*)	29	28	22
Brazil	194	510	21	−4	44	203	86
Chile	23	85	14			49	28
Colombia	16	66	21	1		40	33
Dominican Republic	(*)	(*)	1				1
Ecuador	1	12	3	1		8	6
Guatemala	(*)	9		(*)	9		(*)
Mexico	(*)	25	6	1		18	14
Paraguay	(*)	16	4	(*)	3	8	7
Peru	2	40	8	−1	(*)	25	20
Uruguay	18	36	3	(*)		16	5
Venezuela	(*)			1			1
Other Western Hemisphere	(*)	(*)	(*)	(*)			1
Total, Asia	752	9,220	3,459	−71	6,454	3,672	1,730
Afghanistan	4	6	2	(*)	1	1	4
Burma	8	48	11	(*)	19	19	13
Cambodia	3	18	79		88		7
China (Taiwan)	2	493	31	−3	306	104	109
Hong Kong	1	1		5			6
India	438	4,145	2,441	−71	2,990	2,528	559
Indonesia	222	292	19	−2	32	27	27
Iran	[3] −1	64	20	(*)	9	34	41
Israel	35	412	176	−9	106	300	139
Japan	(*)	193		22	10	106	100
Jordan	(*)	6	2	(*)		4	5
Korea	18	1,030	97	−1	853	13	241
Lebanon	(*)		1	3			4
Malaysia	(*)	(*)		2			2
Nepal	5		2	9	4	(*)	2
Pakistan	138	1,321	160	−25	739	466	112
Philippines	10	142	22	(*)	66	43	44
Sri Lanka (Ceylon)	3	34	6	(*)	7	13	17
Syria	8	35	1	−1		12	15
Thailand	(*)	5	2	1		2	6
Vietnam	[3] −143	973	387	−1	1,224	1	276
Other Asia	(*)	(*)	(*)	(*)	(*)		(*)
Oceania: Australia	(*)			1			1
Canada	(*)			1			1

* Less than $500,000 (plus or minus).

[1] For important qualifications affecting this table and for definitions of terms, see the explanatory note.

[2] Includes foreign currencies acquired from triangular trade operations and principal and interest collections on credits, originally extended under Public Law 83–480, which—since enactment of Public Law 87–128—are available for the same purpose as Public Law 83–480 currencies.

[3] Net assistance is recorded minus (−), reflecting significant gains resulting from disbursement of foreign currency at U.S. dollar equivalent values in excess of values at which currency was acquired.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

SECTION C.–U.S. Government Loan Commitments to Less Developed Countries, 1975

TABLE C–1.—*U.S. Government new loan commitments*[1] *to less developed countries in calendar year 1975, by maturity period and interest rate*

The following table includes loans reported in the U.S. submission for the OECD Development Assistance Committee Annual Aid Review. "Number of credits" is an approximation, since a single commitment may be confirmed in several individual loans, or, conversely, one loan agreement may be augmented by subsequent additional commitments. Number of credits is in units; dollar amount is in millions of dollars and totals do not add due to rounding.

Maturity period (years)[2] and program	Total		Interest rate per annum[3]: 3 percent		4–6 percent[5]		7–7½ percent[6]		8–8¾ percent[7]		9–9¼ percent[8]		9½–10¼ percent[9]		Over 10¼ percent[10]	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Total	[4] 1,654	[4] 4,406	99	1,704	12	71	23	14	1,241	2,151	150	282	98	153	30	29
OFFICIAL DEVELOPMENT ASSISTANCE																
Agricultural Trade Development and Assistance Act (Intergovernmental agreements): ATDA	30	867	29	833	1	35										
Foreign Assistance Act: FAA	[4] 74	[4] 893	70	871	3	19										
OTHER OFFICIAL FLOWS																
Export-Import Bank Act: EIB	993	2,379			8	17	23	14	947	2,085	10	141	5	121		
Commodity Credit Corporation Charter Act: CCC	548	260							293	65	140	141	93	32	22	23
Overseas Private Investment Corporation: OPIC	9	7							1	1					8	6
1 to —5, total	989	356			6	5	9	(*)	718	101	141	196	93	32	22	23
CCC	548	260							293	65	140	141	93	32	22	23
EIB	441	96			6	5	9	(*)	425	36	1	55				
5 to —10, total	473	690			2	12	14	14	451	632	1	28			5	3
EIB	468	687			2	12	14	14	451	632	1	28				
OPIC	5	3													5	3
10 to —15: EIB	70	868							62	811	8	58				
15 to —20, total	11	515	1	1					8	474			2	39		
ATDA	1	1	1	1												
EIB	10	514							8	474			2	39		

TABLE C–1.—*U.S. Government new loan commitments*[1] *to less developed countries in calendar year 1975, by maturity period and interest rate*—Continued

20 to —25, total	16	462	11	243	1	5			1	132			3	82		
ATDA	11	243	11	243												
FAA	1	5			1	5										
EIB	4	214							1	132			3	82		
25+, total	3	49			3	49										
ATDA	1	35			1	35										
FAA	2	14			2	14										
30+, total	2	13	2	13												
ATDA	1	9	1	9												
FAA	1	4	1	4												
40+, total	[4] 86	[4] 1,450	85	1,447												
ATDA	16	580	16	580												
FAA	[4] 70	[4] 870	69	867												
Indeterminate: OPIC	4	4							1	1					3	3

*Less than $500,000.

[1] Includes only credits repayable in dollars. This table excludes the following entries incorporated into the U.S. submission to OECD: commitments for debt reorganization, rescheduling, and capitalization of interest totaling $158,000,000; 1,524 individual transactions totaling $658,000.000, reported as having occurred through the Export-Import Bank "Discount Loan Facility," whereby U.S. commercial banks borrow funds from the Bank for on-lending to foreign purchasers; and 28 loans totaling $4,000,000, under the Bank's "Cooperative Financing Facility," whereby an individual export loan has been authorized by the Bank through a U.S. cooperating bank which has assumed the credit risk of its foreign customer. The Development Assistance Committee excludes from its consideration credits financing sales of military equipment which totaled $826,000,000.

[2] Maturity period is estimated upon assumption that credits are utilized concurrent with authorization, and represents the interval from authorization to final repayment. Maturity period includes any grace period (generally in the first 10 years of 40-year loans) during which time principal installments are nil.

[3] Interest rate specified is that generally prevailing over the greater part of the maturity period; for many credits stated at 3 percent, interest rate during the grace period or during the interval to first principal repayment may be 2 percent.

[4] Includes 1 FAA credit ($3,000,000) at nil percent not shown in separate interest rate columns.

[5] Includes EIB credits at 6 percent; ATDA credit (see footnote 3 above) and 1 FAA credit ($5,000,000) at 4 percent; and 2 FAA credits ($14,000,000) at 5 percent.

[6] Includes 10 credits ($1,000,000) at 7 percent; 1 credit ($6,000,000) at 7.160 percent; and 3 credits ($7,000,000) at 7½ percent.

[7] Includes CCC credits at 8 percent; 911 EIB credits ($1,308,000,000) at 8 percent; 4 EIB credits ($5,000,000) at 8¼ percent; 26 EIB credits ($687,000,000) and OPIC credit at 8½ percent; and 6 EIB credits ($84,000,000) at 8¾ percent.

[8] Includes CCC credits at 9 percent for nine-tenths of each credit, with the remaining part of each payment (guaranteed by U.S. banks) at 8 percent; 9 EIB credits ($140,000,000) at 9 percent; and 1 EIB credit ($1,000,000) at 9⅛ percent.

[9] Includes 11 CCC credits ($6,000,000) and EIB credits at 9½ percent; and 82 CCC credits ($26,000,000) at 10 percent.

[10] Includes 1 CCC credit ($4,000,000) at 10½ percent for nine-tenths of the credit, with the remaining part of the payment (guaranteed by U.S. banks) at 9½ percent; 21 CCC credits ($19,000,000) at 11 percent for nine-tenths of each credit, with the remaining part of each payment (guaranteed by U.S. banks) at 10 percent; 3 OPIC credits ($800,000) at 11 percent; 1 OPIC credit ($600,000) at 11½ percent; and 4 OPIC credits ($4,000,000) with dual interest rates ranging from 8½ percent to 11 percent.

Source: Compiled by Bureau of Economic Analysis, U.S. Department of Commerce, from information made available by operating agencies.

SECTION D.–International Monetary Fund

TABLE D–1.—*International Monetary Fund currency sales, July 1, 1975 to June 30, 1976, by country and currency*
[In millions of SDR's]

Country	Total	Currencies [1]	SDR's
Total	7,629.8	7,121.0	508.8
Afghanistan	8.5	8.5	....
Argentina	296.1	223.6	72.5
Bangladesh	81.5	79.5	2.0
Cameroon	11.8	11.8	....
Central African Republic	7.8	7.8	....
Chile	204.2	204.2	....
Costa Rica	18.8	18.8	....
Cyprus	35.0	35.0	....
Dominican Republic	10.8	10.8	....
Egypt	125.7	125.7	....
Finland	115.1	115.1	....
France	78.3	78.3	....
Greece	86.3	86.3	....
Grenada	1.5	1.4	.1
Haiti	7.4	7.3	.1
Iceland	33.5	33.5	....
India	201.3	201.3	....
Indonesia	80.0	80.0	....
Israel	88.8	85.3	3.5
Italy	780.2	780.2	....
Ivory Coast	36.4	36.4	....
Jamaica	42.5	42.5	....
Kenya	35.6	33.9	1.7
Korea	201.7	201.7	....
Laos	9.8	9.2	.5
Malawi	7.5	7.5	....
Mali	4.0	4.0	....
Mauritania	14.0	14.0	....
Morocco	143.7	143.7	....
Nepal	7.6	7.6	....
New Zealand	230.4	230.4	....
Oman	[2].3	[2].3	....
Pakistan	135.0	135.0	....
Panama	17.3	17.3	....
Papua New Guinea	29.8	27.2	2.6
Peru	189.5	189.5	....
Philippines	258.6	258.6	....
Portugal	144.0	137.0	7.0
Romania	172.5	158.8	13.7
Senegal	9.9	9.9	....
Sierra Leone	12.0	12.0	....
South Africa	171.2	171.2	....
Spain	275.9	275.9	....
Sri Lanka	44.9	44.9	....
Sudan	45.0	45.0	....
Tanzania	41.6	39.5	2.1
Turkey	223.6	223.6	....
Uganda	20.0	20.0	....
United Kingdom	2,400.0	2,003.7	396.3
Uruguay	52.4	52.4	....
Western Samoa	1.8	1.8	....
Yemen, Peoples Democratic Rep. of	17.8	17.8	....
Yugoslavia	185.5	185.5	....
Zaire	89.0	89.0	....
Zambia	86.7	80.0	6.7

[1] Sales of U.S. dollars during the period were equivalent to SDR 2,397.0 million including SDR 1,472.3 million representing Oil Facility borrowings.
[2] Data refer to the Fund's repayment of its 1974 borrowing from Oman.

NOTE.—Detail may not add to totals due to rounding.

Source: International Monetary Fund.

TABLE D-2.—*International Monetary Fund currency sales by currency sold, calendar years, through June 30, 1976*

[In millions of SDR's]

Period	Total	U.S. dollars	Deutsche mark	Italian lire	Canadian dollars	French francs	Pounds sterling	Other [1]
Total	39,871.6	10,035.0	6,322.9	1,995.8	2,213.5	2,405.5	1,499.6	15,399.3
1976 (1st half)	4,907.6	871.0	669.2	...	96.8	262.6	...	3,008.0
1975	4,658.4	356.7	430.4	...	149.3	224.9	97.7	3,399.4
1974	4,053.1	896.4	474.5	...	201.2	137.3	89.0	2,254.7
1973	732.6	...	323.8	18.8	33.6	82.2	...	274.2
1972	1,611.5	...	412.2	59.7	79.8	144.4	257.1	658.2
1971	1,900.3	10.0	228.8	60.9	85.5	100.1	27.9	1,387.1
1970	1,839.3	588.9	393.8	70.3	156.1	...	43.3	586.9
1969	2,871.2	1,341.1	311.0	197.0	293.5	...	4.0	724.6
1968	3,552.4	806.2	841.0	478.0	138.5	82.5	...	1,206.2
1967	834.7	113.6	89.8	46.0	30.0	82.0	247.2	226.1
1966	1,448.3	158.8	239.5	311.8	459.8	77.0	82.4	119.0
1965	2,433.5	282.2	418.1	473.8	290.5	376.8	29.0	563.1
1964	1,949.8	281.9	718.1	31.3	99.0	356.8	7.3	455.4
1963	333.2	193.7	37.5	28.0	...	20.0	5.0	49.0
1962	583.8	109.5	115.6	5.0	...	97.0	199.2	57.5
1947–61	6,162.1	4,024.8	619.7	215.2	100.0	362.0	410.6	429.8

[1] Consisting of Argentine pesos, Australian dollars, Austrian schillings, Bahrain dinars, Belgian francs, Brazilian cruzeiros, Danish kroner, Ecuadoran sucres, Finnish markaa, Indonesian rupiahs, Iranian rials, Irish pounds, Japanese yen, Kuwaiti dinars, Malaysian dollars, Maltese pounds, Mexican pesos, Netherlands guilders, Nigerian naira, Norwegian kroner, Omani rials, Qatar riyals, Saudi Arabian riyals, South African rand, Spanish pesetas, Swedish kronor, Swiss francs, Trinidad & Tobago dollars, U.A.E. dirhams, Venezuelan bolivares, and SDR's.

NOTE.—Data include Fund's repayments of its 1965 borrowings from Canada (SDR 35 million), 1968 borrowings from Belgium (SDR 70 million), 1968 borrowings from Germany (SDR 340 million), 1968, 1969, and 1970 borrowings from Italy (SDR 265 million), and three claims on the Fund transferred to Italy in 1968 and 1969 (SDR 65 million). Regarding the Oil Facility in 1974, 1975 and 1976, Fund's borrowings in U.S. dollars from Austria, Canada, Germany, Netherlands, Nigeria, Oman, Sweden, Switzerland, Trinidad and Tobago and United Arab Emirates which were drawn by other members, are recorded as if the lendings and subsequent sales are made in lending members' currencies.

Detail may not add to totals due to rounding.

Source: International Monetary Fund.

TABLE D-3.—*International Monetary Fund currency repurchases, by currency of repurchase, calendar years, through June 30, 1976*

[In millions of SDR's]

Period	Total	U.S. dollars	Deutsche mark	Italian lire	Canadian dollars	French francs	Other	SDR's	Gold
Total	[1] 18,526.8	4,839.7	2,752.2	999.4	1,265.2	874.0	[2] 4,609.4	1,608.9	1,578.0
1976 (1st half)	717.3	97.5	85.4	...	10.3	37.5	66.6	420.0	...
1975	492.1	121.7	122.7	...	18.1	29.9	162.6	37.1	...
1974	627.6	...	257.2	27.0	26.2	25.2	273.8	18.2	...
1973	635.0	...	189.7	39.6	59.5	51.2	246.4	45.5	3.1
1972	1,526.6	...	337.3	75.2	93.9	120.7	374.8	494.3	30.4
1971	2,812.9	38.3	63.0	.3	351.3	44.5	1,535.4	301.5	478.6
1970	1,403.9	742.0	3.8	67.8	40.4	...	242.1	292.3	15.5
1969	1,585.1	267.7	391.8	271.4	43.2	.1	528.6	...	82.3
1968	1,286.2	...	281.6	327.5	7.3	90.5	493.6	...	85.7
1967	923.4	...	295.2	89.0	45.1	184.0	299.3	...	10.8
1966	480.4	.5	14.7	7.5	412.2	23.1	10.8	...	11.4
1965	381.7	...	121.9	38.5	107.1	19.0	53.9	...	41.4
1964	513.4	4.8	264.6	5.5	...	125.2	93.5	...	19.8
1963	299.2	206.6	2.9	5.0	...	8.0	28.2	...	48.5
1962	1,332.2	719.2	235.4	45.0	50.3	85.0	130.1	...	67.2
1947–61	3,509.7	2,641.4	85.0	...	.4	30.0	69.6	...	683.4

[1] Includes SDR 405 million of repurchases on subscription account and SDR 324.4 million of repurchases of charges paid in currencies.

[2] Consisting of Argentine pesos, Australian dollars, Austrian schillings, Belgian francs, Danish kroner, Irish pounds, Japanese yen, Kuwaiti dinars, Mexican pesos, Netherlands guilders, Norwegian kroner, pounds sterling, South African rand, Spanish pesetas, Swedish kronor, United Arab Emirates dirhams and Venezuelan bolivares.

NOTE.—Detail may not add to totals due to rounding.

Source: International Monetary Fund.

TABLE D-4.—*International Monetary Fund special drawing account report on holdings by IFS grouping*

[As of June 30, 1976]

Participants	Allocations	Net receipts or net use (−)	SDR holdings[1] Amount	Percent of allocations
Industrial Countries	6,177.7	813.4	6,991.0	113.2
United States	2,294.0	−273.3	2,020.7	88.1
Canada	358.6	121.5	480.1	133.9
Japan	377.4	82.8	460.2	122.0
Austria	76.7	19.1	95.9	124.9
Belgium	209.4	354.0	563.3	269.1
Denmark	82.8	−.9	81.9	98.9
France	485.0	−293.3	191.7	39.5
Germany	542.4	1,090.3	1,632.7	301.0
Italy	318.0	−243.4	74.7	23.5
Luxembourg	7.3	......	7.3	100.0
Netherlands	236.5	294.9	531.4	224.7
Norway	76.3	13.1	89.5	117.2
Sweden	107.0	......	107.0	100.0
Switzerland	......	......	......	......
United Kingdom	1,006.3	−351.5	654.8	65.1
Other Europe	405.1	−109.0	296.1	73.1
Finland	61.5	1.7	63.2	102.7
Greece	46.2	−33.2	13.0	28.1
Iceland	7.4	−4.0	3.4	45.8
Ireland	39.2	6.1	45.3	115.6
Malta	5.1	.1	5.2	101.2
Portugal	......	4.6	4.6	......
Romania	......	16.1	16.1	......
Spain	126.1	−19.6	106.6	84.5
Turkey	50.3	−31.4	18.9	37.5
Yugoslavia	69.3	−49.4	19.9	28.7
Australia, New Zealand, South Africa	384.0	−296.9	87.1	22.7
Australia	225.6	−185.6	40.1	17.8
New Zealand	69.4	−67.9	1.5	2.3
South Africa	88.9	−43.4	45.5	51.2
Oil Exporting Countries	374.2	−49.9	324.2	86.6
Algeria	40.3	2.8	43.1	106.9
Indonesia	90.2	−86.1	4.1	4.5
Iran	61.9	−.6	61.3	99.1
Iraq	23.2	4.8	28.0	120.5
Kuwait	......	......	......	......
Libya	......	......	......	......
Nigeria	45.6	15.6	61.2	134.2
Oman	.7	......	.7	100.0
Qatar	......	......	......	......
Saudi Arabia	......	......	......	......
United Arab Emirates	......	......	......	......
Venezuela	112.3	13.7	126.0	112.2
Other Less Developed Areas	1,974.0	−905.0	1,069.0	54.2
Other Western Hemisphere	766.8	−309.4	457.4	59.7
Argentina	152.5	−88.7	63.8	41.8
Bolivia	12.8	−5.8	6.9	54.2
Brazil	152.5	18.4	171.0	112.1
Chile	54.7	−16.2	38.5	70.4
Colombia	54.4	−35.5	18.9	34.8
Costa Rica	11.0	−8.6	2.5	22.2
Dominican Republic	14.5	−8.3	6.2	42.8
Ecuador	11.2	−5.0	6.3	55.7
El Salvador	11.7	−7.8	3.9	33.0

See footnote at end of table.

Table D-4.—*International Monetary Fund special drawing account report on holdings by IFS grouping*—Continued

[As of June 30, 1976]

Participants	Allocations	Net receipts or net use (−)	SDR holdings [1] Amount	SDR holdings [1] Percent of allocations
Less Developed Areas—Continued				
Guatemala	11.9	−.4	11.4	96.4
Haiti	6.6	−5.0	1.6	24.4
Honduras	8.5	−5.3	3.2	38.0
Mexico	124.2	−38.4	85.8	69.1
Nicaragua	8.9	−5.1	3.8	42.7
Panama	12.4	−6.2	6.2	50.1
Paraguay	6.6	....	6.6	100.0
Peru	40.5	−34.2	6.3	15.5
Uruguay	23.9	−23.0	1.0	4.0
Bahamas	....	....	....	....
Barbados	2.8	....	2.8	100.0
Grenada	....	....	....	....
Guyana	6.8	−3.2	3.6	53.5
Jamaica	17.7	−17.7	....	.1
Trinidad and Tobago	20.8	−13.6	7.2	34.6
Other Middle East	153.6	−117.3	36.3	23.6
Bahrain	....	....	....	....
Cyprus	8.9	.4	9.3	104.4
Egypt	65.2	−58.9	6.4	9.8
Israel	42.8	−41.5	1.4	3.2
Jordan	7.6	−.2	7.4	97.2
Lebanon	....	....	....	....
Syria	17.0	−10.3	6.8	39.8
Yemen Arab Republic	2.1	....	2.1	100.0
Yemen, People's Democratic Republic	9.9	−6.9	3.0	30.3
Other Asia	674.9	−266.2	408.6	60.5
Afghanistan	12.8	−7.5	5.3	41.2
Bangladesh	......	13.0	13.0	....
Burma	20.8	−14.0	6.8	32.6
Cambodia	8.5	−8.2	.3	3.9
China, Republic of	....	....	....	....
India	326.2	−136.6	189.6	58.1
Korea	22.2	−18.5	3.7	16.7
Laos, People's Democratic Republic	4.5	−3.0	1.5	33.5
Malaysia	60.6	5.3	66.0	108.8
Nepal	2.2	....	2.2	99.1
Pakistan	81.6	−42.0	39.6	48.5
Philippines	51.5	−35.6	15.9	30.8
Singapore	....	....	....	....
South Vietnam	19.8	....	19.7	99.9
Sri Lanka	34.0	−22.2	11.8	34.7
Thailand	28.5	1.0	29.6	103.6
Fiji	1.4	−.1	1.3	96.4
Papua New Guinea	......	2.4	2.4	....
Western Samoa	.2	−.2	....	....
Other Africa	378.7	−212.1	166.6	44.0
Benin	4.5	....	4.5	100.0
Botswana	1.6	....	1.6	100.0
Burundi	6.6	−3.5	3.1	46.7
Cameroon	10.5	−.8	9.7	92.3
Central African Republic	4.4	−2.5	1.9	43.6
Chad	4.5	−2.4	2.1	47.2
Congo, People's Republic	4.5	−2.4	2.1	46.3
Equatorial Guinea	2.7	−.9	1.8	65.3

See footnote at end of table.

TABLE D-4.—*International Monetary Fund special drawing account report on holdings by IFS grouping*—Continued

[As of June 30, 1976]

Participants	Allocations	Net receipts or net use (−)	SDR holdings [1]	
			Amount	Percent of allocations
Other Africa—Continued				
Ethiopia	......	......	......	......
Gabon	4.8	−.2	4.6	96.5
Gambia, The	2.3	−.3	3.0	85.8
Ghana	30.1	−24.8	5.3	17.7
Guinea Republic	8.3	−5.5	2.8	33.5
Ivory Coast	14.3	−.7	13.6	95.0
Kenya	15.6	−15.1	.5	3.1
Lesotho	1.6	−1.1	.5	31.8
Liberia	9.5	−6.0	3.5	36.9
Madagascar	8.7	−8.6	.1	1.3
Malawi	5.1	−.6	4.5	87.6
Mali Republic	7.5	−4.9	2.6	34.6
Mauritania	4.5	−3.0	1.5	33.0
Mauritius	7.4	−4.9	2.5	34.1
Morocco	39.2	−26.2	13.0	33.2
Niger	4.5	−.1	4.4	98.7
Rwanda	6.6	−4.3	2.3	34.6
Senegal	11.4	−9.4	2.1	18.2
Sierra Leone	7.8	−4.4	3.5	44.5
Somalia	6.6	−2.3	4.3	65.0
Sudan	24.9	−24.3	.6	2.6
Swaziland	2.7	−1.8	.9	34.7
Tanzania	14.3	−13.9	.5	3.3
Togo	5.1	......	5.1	100.0
Tunisia	14.7	−4.7	10.0	67.8
Uganda	13.9	−12.0	1.9	13.7
Upper Volta	4.5	......	4.4	99.6
Zaire	39.2	−7.7	31.5	80.4
Zambia	24.6	−13.0	11.6	47.0
Participants' holdings	9,314.8	−547.4	8,767.3	94.1
General account	......	547.4	547.4	......
Total holdings	9,314.8	......	9,314.8	......

[1] The SDR is defined as equivalent to .888671 gram of fine gold, i.e., equivalent to the U.S. dollar at its par value of December 1946.

Source: International Monetary Fund.

TABLE D-5.—*IMF Standby arrangements—amounts available under arrangements in effect on June 30, 1976*

[In millions of SDR's]

Country	Date of Arrangement	Date of Expiration	Amounts Agreed	Amounts Drawn	Amounts Available
Total			1,035.2	915.3	119.9
Afghanistan	July 16, 1975	July 15, 1976	8.5	8.5	....
Bangladesh	July 28, 1975	July 27, 1976	62.5	41.0	21.5
Burundi	June 5, 1976	Mar. 31, 1977	6.5	....	6.5
Grenada	June 30, 1976	Dec. 31, 1976	.2	....	.2
Guyana	June 18, 1976	June 17, 1977	7.3	....	7.3
Haiti	Aug. 1, 1975	July 31, 1976	4.8	3.3	1.5
Liberia	Jan. 14, 1976	Jan. 13, 1977	5.0	....	5.0
Nepal	Feb. 18, 1976	Feb. 17, 1977	4.5	4.5	....
Panama	Nov. 8, 1975	Nov. 7, 1976	9.0	....	9.0
Romania	Oct. 3, 1975	Oct. 2, 1976	95.0	77.5	17.5
South Africa	Jan. 21, 1976	Jan. 20, 1977	80.0	80.0	....
Tanzania	Aug. 21, 1975	Aug. 20, 1976	10.5	....	10.5
United Kingdom	Dec. 31, 1975	Dec. 30, 1976	700.0	700.0	....
Western Samoa	Nov. 12, 1975	Nov. 11, 1976	.5	.5	....
Zaire	Mar. 22, 1976	Mar. 21, 1977	41.0	....	41.0

NOTE.—Detail may not add to totals due to rounding.

Source: International Monetary Fund.

TABLE D-6.—*Fund borrowings under the General Arrangements to Borrow, from inception to June 30, 1975 and fiscal year 1976*

[Expressed in millions of SDR's]

	Arrangements end of 1964 [1]	Cumulative operations, inception—June 30, 1975: Borrowings	Transfers of claims	Repayments	Available June 30, 1975	Operations in fiscal year 1976: Borrowings	Repayments	Available June 30, 1976
Belgium	150.0	137.5	10.0	147.5	172.1	....	....	164.9
Canada	200.0	140.0	30.0	170.0	169.0	....	....	194.7
France	550.0	240.0	−140.0	100.0	544.0	....	....	500.0
Germany	1,000.0	897.5	−130.0	767.5	1,374.0	....	....	1,357.4
Italy	550.0	335.0	105.0	440.0	438.3	....	....	333.1
Japan	250.0	150.0	85.0	235.0	246.4	....	....	263.2
Netherlands	200.0	177.5	40.0	217.5	240.1	....	....	231.4
Sweden	100.0	77.5	....	77.5	105.5	....	....	101.8
United Kingdom	1,000.0	....	....	....	662.9	....	....	572.3
United States	2,000.0	....	....	....	1,617.6	....	....	1,745.1
Total	6,000.0	2,155.0	....	2,155.0	[1] 5,569.9	....	....	[1] 5,463.8

[1] Since lending commitments are expressed in national currency, their amounts expressed in SDR's change with changes in a country's par value or exchange rate. (1 SDR equals $1 prior to May 8, 1972, $1.08571 to Oct. 18, 1973, $1.20635 through June 30, 1974, and is valued daily by a "basket" of currencies since July 1, 1974.)

NOTE.—Detail may not add to totals due to rounding.

Source: International Monetary Fund.

TABLE D-7.—*International Monetary Fund—Compensatory Financing Facility Drawings*

[Millions of SDR's]

	Period (calendar years)				
	Cumulative 1963–1973	1974	1975	Jan.–June 1976	Cumulative 1963–76 (June)
All Countries	875.5	107.2	239.1	955.9	2,177.7
Industrial	36.7		88.3	194.8	319.8
Iceland	7.5			11.5	19.0
New Zealand	29.2		50.5	50.5	130.2
Romania				95.0	95.0
Turkey			37.8	37.8	76.6
Less Developed	838.8	107.2	150.8	761.1	1,857.9
Africa	97.3	6.0	37.0	244.3	384.8
Burundi	2.5				2.5
Central African Republic				5.1	5.1
Ghana	17.3				17.3
Guinea		6.0			6.0
Ivory Coast				26.0	26.0
Mauritania				6.5	6.5
Morocco				56.5	56.5
Sierra Leone				7.0	7.0
Sudan	11.3		18.0	26.7	56.0
Tanzania				21.0	21.0
Uganda				20.0	20.0
Zaire	28.2			56.5	84.7
Zambia	38.0		19.0	19.0	76.0
Asia	299.5	82.9	3.8	130.8	517.0
Afghanistan	4.8				4.8
Bangladesh	62.5				62.5
Burma	14.0	15.0			29.0
Cambodia	12.5				12.5
India	90.0	62.0			152.0
Korea				40.0	40.0
Laos			3.3	3.3	6.5
Papua New Guinea				10.0	10.0
Philippines	38.8			77.5	116.3
Sri Lanka	76.9	5.9			82.8
Western Samoa			0.5		0.5
Middle East	132.8			109.5	242.3
Cyprus				13.0	13.0
Egypt	86.0			94.0	180.0
Iraq	17.5				17.5
Jordan	7.3				7.3
Syria	22.0				22.0
Yemen (PDR)				2.5	2.5
Latin America	309.2	18.3	110.0	276.4	713.9
Argentina	64.0		110.0	110.0	284.0
Brazil	60.0				60.0
Chile	79.0			79.0	158.0
Colombia	20.8				20.8
Dominican Republic	6.6				6.6
Ecuador	6.3				6.3
El Salvador	6.3				6.3
Guatemala	6.3				6.3
Guyana		5.0			5.0

See footnote at end of table.

[Millions of SDR's]

	Period (calendar years)				
	Cumulative 1963–1973	1974	1975	Jan.–June 1976	Cumulative 1963–76 (June)
Latin America—Continued					
Haiti	2.3				2.3
Jamaica	....	13.3			13.3
Peru	30.8			61.5	92.3
Uruguay	26.8			25.9	52.7

Source: International Monetary Fund

TABLE D-8.—*International Monetary Fund—Oil Facility Drawings*

[Millions of SDR's]

	Period (calendar years)			
	1974	1975	Jan.–June 1976	Cumulative 1974–76 (June)
All Countries	1,715.8	3,043.2	2,143.4	6,902.4
Industrial	951.3	1,768.8	1,643.3	4,363.4
Finland	......	71.3	115.1	186.4
Greece	36.2	119.0	......	155.2
Iceland	15.5	10.1	13.6	39.2
Italy	675.0	780.2	......	1,455.2
New Zealand	85.7	106.1	46.9	238.7
Portugal	......	......	114.8	114.8
Spain	......	496.2	75.9	572.1
Turkey	......	169.8	91.5	261.3
United Kingdom	......	......	1,000.0	1,000.0
Yugoslavia	139.0	16.2	185.5	340.7
Less Developed	764.5	1,274.4	500.1	2,539.0
Africa	130.0	238.9	95.7	464.6
Burundi	......	1.2	......	1.2
Cameroon	4.6	7.5	4.3	16.4
Central African Republic	2.7	2.3	1.0	6.0
Chad	2.2	......	......	2.2
Ghana	......	38.6	......	38.6
Guinea	3.5	......	......	3.5
Ivory Coast	11.2	......	10.4	21.6
Kenya	32.0	28.8	3.1	63.9
Madagascar	3.5	10.9	......	14.4
Malawi	......	2.4	1.4	3.8
Mali	4.0	1.0	4.0	9.0
Mauritania	......	......	5.3	5.3
Morocco	......	......	18.0	18.0
Senegal	......	25.4	......	25.4
Sierra Leone	4.3	0.6	5.0	9.9
Sudan	28.7	18.3	......	47.0
Tanzania	28.4	23.8	......	52.2
Uganda	5.0	14.2	......	19.2
Zaire	......	45.0	32.5	77.5
Zambia	......	18.9	10.8	29.7
Asia	463.0	577.3	187.2	1,227.5
Bangladesh	40.4	36.7	14.7	91.8
Fiji	0.3	......	......	0.3
India	200.0	201.3	......	401.3
Korea	90.0	107.3	55.4	252.7
Pakistan	97.9	103.4	34.7	236.0
Papua New Guinea	......	......	14.8	14.8
Philippines	......	96.9	55.2	152.1
Sri Lanka	34.0	31.3	12.4	77.7
Western Samoa	......	0.3	0.2	0.5
Middle East	15.7	152.1	61.1	228.9
Cyprus	6.4	1.7	22.0	30.1
Egypt	......	......	31.7	31.7
Israel	......	143.3	......	143.3
Yemen (PDR)	9.3	7.1	7.4	23.8
Latin America	156.1	306.1	156.1	618.3
Argentina	......	76.1	......	76.1

[Millions of SDR's]

	Period (calendar years)			
	1974	1975	Jan.–June 1976	Cumulative 1974–76 (June)
Chile	41.5	156.8	45.4	243.7
Costa Rica	18.8	12.0	6.8	37.6
El Salvador	17.9	.....	.....	17.9
Grenada	.....	0.3	0.2	0.5
Haiti	3.8	2.6	2.6	9.0
Honduras	16.8	.....	.....	16.8
Jamaica	.....	.....	29.2	29.2
Nicaragua	3.3	12.2	.....	15.5
Panama	7.4	10.2	7.1	24.7
Peru	.....	.....	52.7	52.7
Uruguay	46.6	35.9	12.1	94.6

SECTION E.—International Bank for Reconstruction and Development

TABLE E-1.—*IBRD loans approved, by area, country and purpose, July 1, 1975 to June 30, 1976*

[Millions of dollars]

Area, country	Amount	Purpose
Total	4,977.1	
Total, Africa	1,022.2	
Algeria	46.0	Cement
	47.0	Education
	57.5	Power
Botswana	5.8	Roads
	10.5	Education [1]
Cameroon	17.0	Education [2]
	2.3	Railways
Congo	38.0	Railways
East African Comm.	15.0	Development Finance Co.
Egypt	45.0	Port
	50.0	Ag. Fruit and Vegetable [2]
	10.0	Ag. Drainage [3]
	52.0	Industry-Textiles
Ghana	10.0	Development Finance Co.
	18.0	Highways [4]
	14.0	Ag. Devt.—Cocoa
	21.0	Rural Devt. [2]
Ivory Coast	5.6	Development Finance Co.
	43.0	Roads
	8.0	Development Finance Co.
Kenya	63.0	Power
	10.0	Development Finance Co.
	35.0	Water Supply
	10.0	Education
Liberia	1.8	Power
	27.5	Highways
	4.0	Education [2]
Malawi	9.2	Irrigation [2]
Mauritius	7.5	Development Finance Co.
Morocco	30.0	Irrigation
	21.0	Tourism
	25.0	Education [2]
	25.0	Development Finance Co.
	49.0	Power
Senegal	15.0	Highways
	6.6	Highways [2]
Sudan	20.0	Transportation-Aviation [5]
Tanzania	15.0	Development Finance Co.
Togo	60.0	Industry
Tunisia	8.9	Education
	28.0	Highways
	20.0	Development Finance Co.
Zambia	15.0	Development Finance Co.
Total, Asia	1,781.5	
Fiji	5.0	Telecommunication
	12.0	Ag. Devt.—Sugar
India	145.0	Irrigation [2]
	40.0	Development Finance Co.
	25.0	Ag. Seed Research
Indonesia	68.0	Shipping
	13.0	Technical Assistance
	130.0	Highways
	37.0	Education
	54.0	Shipping
	70.0	Fertilizer
	90.0	Power
	22.0	Ag. Devt.
	33.0	Irrigation
Korea	55.0	Development Finance Co.
	15.0	Livestock
	30.0	Development Finance Co.
	90.0	Highways
	75.0	Program Loan
	60.0	Rural Development [6]
Malaysia	35.0	Power
	21.5	Sewerage
	26.0	Urban Transport
	21.0	Rural Development
Pakistan	50.0	Power [2]
Philippines	42.0	Irrigation
	75.0	Development Finance Co.
	25.0	Education [2]
	20.5	Livestock
	50.0	Irrigation
	11.5	Ag. Devt.—Grain
	12.0	Fisheries
	32.0	Urban Development [6]
Syria	35.0	Water Supply
	28.0	Telecommunications
Thailand	95.0	Irrigation
	5.0	Livestock [2]
	21.0	Rural Development [2]

See footnotes at end of table.

TABLE E-1.—*IBRD loans approved, by area, country and purpose, July 1, 1975 to June 30, 1976*—Continued

[Millions of dollars]

Area, country	Amount	Purpose
	50.0	Ag. Devt.—Rubber
	26.0	Telecommunications
	31.0	Education
Total, Europe..	764.5	
Cyprus	6.0	Development Finance Co.
Greece	40.0	Irrigation
	30.0	Roads
Ireland	30.0	Development Finance Co.
Portugal	36.0	Power
Romania	20.0	Flood Recovery—Industry
	40.0	Flood Recovery—Agriculture
	50.0	Power
	60.0	Irrigation & Ag. Devt.
Turkey	56.0	Power
	63.0	Development Finance Co.
	70.0	Industry
	21.5	Livestock
Yugoslavia	40.0	Highways
	49.0	Pipeline
	20.0	Water Supply
	45.0	Water Supply and Sewerage
	38.0	Pollution Control
	50.0	Industry
Total, Latin America	1,408.9	
Bolivia	9.5	Rural Development [2]
	25.0	Power
	10.0	Development Finance Co.
Brazil	60.0	Steel
	75.0	Railways
	12.0	Rural Development
	55.0	Roads
	85.0	Development Finance Co.
	40.0	Agriculture Research
	52.0	Power
	50.0	Fertilizer
	19.0	Nutrition
	50.0	Power
Caribbean Region ...	20.0	Development Finance Co.[6]
Chile	33.0	Industry—Copper
Colombia	80.0	Development Finance Co.
Costa Rica	39.0	Highways
Ecuador	3.0	Ag.—Seed Research
	10.5	Highways
	4.0	Rural Development
	33.5	Port
El Salvador	39.0	Power [6]
Guatemala	14.5	Education
Honduras	3.0	Ports [8]
Jamaica	6.8	Population and Nutrition
Mexico	40.0	Water Supply
	50.0	Development Finance Co.
	125.0	Agric. and Livestock
	100.0	Railways
Nicaragua	5.0	Port [8]
	11.0	Education
Panama	12.0	Water Supply and Sewerage
Paraguay	4.0	Education [2]
Peru	76.5	Highways
	36.0	Power
	40.0	Industry—Mining
	21.6	Urban Devt.—Sites and Services
Trinidad and Tobago	7.0	Highways
Uruguay	17.0	Livestock
	35.0	Industry

[1] Joint Third Window/IBRD financing.
[2] Project is financed with Third Window funds.
[3] Joint IBRD/IDA financing totaling $50.0.
[4] Joint Third Window/IDA financing totaling $28.0.
[5] Joint Third Window/IDA financing totaling $29.0.
[6] Joint Third Window/IBRD financing.
[8] Supplementary Financing.

Source: International Bank for Reconstruction and Development.

TABLE E–2.—*IBRD loan commitments, and disbursements, by fiscal years through June 30, 1976*

[In millions of U.S. dollars]

Fiscal year	Number of loans	Loan commitments	Disbursements
Total	1,292	33,380[a]	19,961
1976	141	5,047	2,535
1975	122	4,370	2,096
1974	105	3,328	1,608
1973	73	2,091	1,209
1972	72	2,026	1,202
1971	78	1,921	955
1970	69	1,680[b]	722
1969	82	1,399	762
1968	44	847	772
1967	46	877	790
1966	37	839	668
1965	38	1,023	606
1964	37	810	559
1963	28	449	620
1962	29	882	485
1961	27	610	398
1947 to 1960	264	5,181	3,922

[a] Includes cancellations, refundings, and terminations totaling $883,315,000 and loans approved but not yet effective totaling $3,353,400,000. Excludes Pakistan loans totaling $54.9 milion consolidated into one loan to Bangladesh.

[b] A $100,000,000 Bank loan to IFC in 1966 was consolidated into a single loan of $200,000,000 in December 1969. The first $100,000,000 is included in fiscal year 1967. The Bank lent an additional $60,000,000 in fiscal year 1972, $40,000,000 in fiscal year 1973, $110,000,000 in fiscal year 1974, $50,000,000 in fiscal year 1975 and $70,000,000 in fiscal year 1976.

NOTE.—Detail may not add to total due to rounding.

Source: International Bank for Reconstruction and Development.

TABLE E–3.—*IBRD statement of changes in financial position, fiscal year ended June 30, 1976*

[In millions of U.S. dollars]

FUNDS PROVIDED	
Operations:	
Net income	220
Items not requiring or providing cash:	63
Cash provided by operations	283
Borrowings	3,921
Repayments of loans to the Bank	609
Adjustment of loans outstanding as a result of currency depreciation and appreciations	543
Sales of loans	44
Increase (decrease) in amounts payable for investment securities traded	262
Decrease in amounts receivable for investment securities traded	2
Capital subscriptions and maintenance of value adjustments	34
Other	2
Total funds provided	5,700
FUNDS USED	
Disbursements on loans	2,535
Retirement of borrowings	1,278
Adjustment of borrowings as a result of currency depreciations and appreciations	284
Translation adjustments as a result of currency depreciations and appreciations during fiscal year	151
Payments on transfers to the International Development Association	6
Other	220
Total funds used	4,474
INCREASE IN UNRESTRICTED CURRENCIES AND INVESTMENTS	1,226

NOTE.—Detail may not add to totals due to rounding.

Source: International Bank for Reconstruction and Development.

TABLE E-4.—*IBRD gross borrowings in fiscal year 1976*

[Expressed in millions of U.S. dollars]

Date	Type of issue	New funds	Old funds	Totals
Total		2,902.8	905.5	3,808.3
1975:				
July 14	8.64 percent Y serial obligations of 1975, due 1981/82 (second drawing)	....	40.5	40.5
July 15	8.30 percent—5 year notes of 1975, due 1980	300.0	....	300.0
July 15	8.60 percent—10 year notes of 1975, due 1985	200.0	....	200.0
Aug. 1	8 percent—DM note of 1975, due 1980	....	61.6	61.6
Aug. 1	8 percent—DM note of 1975, due 1980	....	63.1	63.1
Sept. 15	8.40 percent—2 year bonds of 1975, due 1977	180.0	170.0	350.0
Sept. 22	8.50 percent—Y serial obligations of 1975, due 1981/82 (third drawing)	....	40.5	40.5
Sept. 25	8.50 percent notes of 1975, due 1978/82 (Yugoslavia)	50.0	....	50.0
Sept. 29	8.50 percent Y serial obligations of 1975, due 1981/82 (fourth drawing)	....	6.8	6.8
Oct. 21	6.10 percent DM loan of 1975, due 1976	57.8	....	57.8
Oct. 29	8 percent loan of 1975, due 1979 Westdeutsche Landesbank Girozentrale, New York branch	20.0	....	20.0
Nov. 11	7½ percent—SwF bonds of 1975, due 1980 (Libya)	4.3	33.8	38.1
Nov. 17	7¾ percent—SwF 15 year bonds of 1975, due 1990	38.1	....	38.1
Nov. 26	7¾ percent—SwF bonds of 1975, due 1981	37.9	....	37.9
Dec. 1	8 percent—DM bonds of 1975, due 1982	96.1	....	96.1
Dec. 11	8 percent—loan of 1975, due 1979 The Long-Term Credit Bank of Japan, Ltd., New York branch	5.0	....	5.0
Dec. 11	8.25 percent Y serial obligations of 1975, due 1981/82 (fifth drawing)	....	7.6	7.6
Dec. 15	8.35 percent—5 year notes of 1975, due 1980	50.0	200.0	250.0
Dec. 15	8.85 percent—10 year notes of 1975, due 1985	250.0	....	250.0
Dec. 15	9.35 percent—25 year bonds of 1975, due 2000	250.0	....	250.0
Dec. 22	7½ percent—SwF notes of 1975, due 1980	75.2	....	75.2
1976:				
Jan. 13	5.75 percent—DM loan of 1976, due 1977	76.9	....	76.9
Jan. 14	8¼ percent Y serial obligations of 1975, due 1981/82 (sixth and final drawing)	....	39.3	39.3
Jan. 22	7¾ percent—SwF bonds of 1976, due 1984 (Saudi Arabia)	115.1	....	115.1
Jan. 23	8¼ percent—DM bonds of 1976, due 1986 (Saudi Arabia)	38.4	....	38.4
Feb. 1	8 percent—7 year Neth f. notes of 1976, due 1983	37.2	....	37.2
Feb. 1	7¾ percent—DM note of 1976, due 1981	....	96.1	96.1
Feb. 1	8 percent—DM bonds of 1976, due 1984	95.8	....	95.8
Mar. 3	8¼ percent—10 year Neth f. loan of 1976, due 1982/86	18.7	....	18.7
Mar. 15	7 percent—2 year bonds of 1976, due 1978	257.7	92.3	350.0
Mar. 22	8¼ percent Y serial obligations of 1976, due 1982/83 (first drawing)	....	39.3	39.3
Mar. 22	8½ percent—loan of 1976, due 1977–2001 (third window)	126.6	....	126.6
Mar. 29	8¼ percent Y serial obligation of 1976, due 1982/83 (second drawing)	....	6.6	6.6
Apr. 2	8¼ percent—10 year Neth f. loan of 1976, due 1982/86	55.6	....	55.6
Apr. 26	8 percent—DM 10 year notes of 1976, due 1986 (Kuwait)	155.3	....	155.3
Apr. 26	7 percent—SwF notes of 1976, due 1982/83	97.8	....	97.8
Apr. 26	7 percent—SwF notes of 1976, due 1982/83	39.4	....	39.4
Apr. 27	7½ percent—DM bonds of 1976, due 1983	118.2	....	118.2
May 11	8.20 percent Neth f. loan of 1976	18.6	....	18.6
May 15	8 percent 10 year Neth f. bonds of 1976, due 1982/86	37.1	....	37.1
June 11	8¼ percent Y serial obligation of 1976, due 1982/83 (third drawing)	....	8.0	8.0
	Total FY 1976	2,902.8	905.5	3,808.3

NOTE.—U.S. dollar denominated except where indicated.

Source: International Bank for Reconstruction and Development.

TABLE E-5.—*IBRD borrowings and outstanding issues as of June 30, 1976*

[In millions of U.S. dollars]

	Number of issues	Original amount [a]	Outstanding amount	Outstanding issues
Total	298	24,894	14,647	161
U.S. dollars	109	14,185	7,151	41
Belgian francs	4	84	71	3
Canadian dollars ..	9	217	154	6
Deutsche mark ...	81	5,124	3,199	45
French francs	1	32	31	1
Italian lire	3	71	71	3
Japanese yen	18	2,024	1,495	13
Kuwaiti dinars ...	6	442	391	6
Lebanese pounds .	1	31	31	1
Libyan dinars	2	135	101	1
Netherlands guilders	14	380	313	11
Pounds sterling ..	4	53	28	2
Saudi Arabian riyals	1	142	142	1
Swedish kronor ...	2	34	34	2
Swiss francs	40	1,742	1,237	22
United Arab Emirates dirhams ..	1	76	76	1
Venezuelan bolivares	2	124	124	2

[a] Includes amounts receivable under contracts.

NOTE.—Detail may not add to totals due to rounding.

Source: International Bank for Reconstruction and Development.

TABLE E-6.—*Estimated Effects of IBRD Operations on United States Balance of Payments from Inception of IBRD through June 30, 1976*

[In millions of U.S. dollars]

	Inception through June 30, 1968	Fiscal Year 1969	1970	1971	1972	1973	1974	1975	1976	Inception through June 30, 1976
Received by IBRD from United States:										
1 percent subscription	64					1				65
9 percent subscription	571						12			583
Net IBRD bond sales	1,373	252	48	372	365	(40)	(50)	436	941	3,697
Net IBRD loan sales	218	(37)	(37)	(18)	(2)	(2)	(12)	(20)	(20)	70
Investment income	568	71	121	152	150	166	199	304	334	2,065
Total	2,794	286	132	506	513	125	149	720	1,255	6,480
Paid by IBRD to United States:										
Procurement of goods[1]	3,077	120	157	211	214	186	203	293	322	4,783
Interest to loan holders	140	10	9	7	7	5	6	5	5	194
Interest to bond holders	585	76	88	110	132	139	135	153	236	1,654
Administrative expenses (including net bond issuance costs)	244	41	40	53	64	66	75	96	117	796
Total	4,046	247	294	381	417	396	419	547	680	7,427
Net paid by IBRD to United States	1,252	(39)	162	(125)	(96)	271	270	(173)	(575)	947
Long-term investments[2]	680	404	414	82	512	2	186	(1,353)	(274)	653
Net paid by IBRD to United States and long-term investments	1,932	365	576	(43)	416	273	456	(1,526)	(849)	1,600

[1] Includes procurement specifically identified as originating in the United States and the same proportion of procurement not identifiable by country of origin.

[2] Maturities over one year.

Source: International Bank for Reconstruction and Development.

SECTION F.—International Development Association

TABLE F–1.—*IDA credits approved, by area, country and purpose, July 1, 1975 to June 30, 1976*

[Millions of dollars]

Area, country	Amount	Purpose
Total	1,655.3	
Total, Africa	447.9	
Benin	9.0	Highways [a]
Burundi	5.2	Coffee
	1.5	Technical Assistance
	6.0	Fisheries
Cameroon	3.0	Development Finance Co.
	15.0	Roads [a]
Chad	5.0	Polders
Egypt	25.0	Development Finance Co.
	40.0	Agric. Drainage [1]
Ethiopia	27.0	Ag. Devt.—Rangelands
Gambia	4.0	Tourism
	4.1	Rural Development
Ghana	10.0	Highways [a]
Guinea	14.0	Roads
Lesotho	5.5	Roads
Liberia	6.0	Agriculture
Madagascar	5.6	Highways [a]
	22.0	Highways
Malawi	11.6	Education
Mali	10.0	Highways
Mauritania	8.0	Port
Niger	10.7	Rural Development
	15.6	Highways
	5.2	Telecommunications
Rwanda	9.5	Highways [a]
Senegal	2.0	Agriculture Devt.
	4.2	Livestock
	6.3	Irrigation
Sierra Leone	7.3	Education
Somalia	5.2	Port
	8.0	Irrigation
	10.0	Agriculture Devt.
Sudan	7.0	Development Finance Co.
	4.0	Technical Assistance
	9.0	Transportation—Aviation [3]
Tanzania	10.0	Dairy
	6.0	Technical Assistance
	18.0	Agric. Devt.—Maize
	11.0	Education
Togo	9.5	Rural Development
Upper Volta	9.4	Rural Development
Zaire	21.0	Education
	21.5	Water Supply
Total, Asia	1,167.9	
Afghanistan	10.0	Irrigation
	10.0	Power
	15.0	Rural Devt. and Livestock
Bangladesh	4.6	Transportation [a]
	100.0	Program Credit
	22.0	Irrigation
	12.0	Education
	7.5	Technical Assistance
	25.0	Development Finance Co.
	16.0	Rural Development
Burma	7.5	Livestock
	30.0	Irrigation
India	57.0	Power
	40.0	Water Supply and Sewerage
	110.0	Railways
	105.0	Fertilizer
	4.0	Forestry
	150.0	Power
	18.0	Agric. Devt.—Cotton
	200.0	Program Credit
Jordan	6.0	Tourism
	4.0	Development Finance Co.
Nepal	26.0	Power
	8.0	Rural Development
Pakistan	8.0	Tarbela Dam [a]
	23.0	Agric.—Seed Research
	50.0	Program Credit
	26.6	Sewerage
	14.0	Irrigation
Sri Lanka	25.0	Agriculture Devt.
Yemen Arab Republic	8.0	Education
	10.3	Irrigation
	5.2	Grain Storage & Processing
Yemen, PDR	3.2	Port
	7.0	Agriculture
Total, Latin America	39.5	
Haiti	5.5	Education
	16.0	Power
Honduras	14.0	Agriculture Credit
Paraguay	4.0	Program Credit

[1] Joint IBRD/IDA financing totaling $50.0.
[2] Joint Third Window/IDA financing totaling $28.0.
[3] Joint Third Window/IDA financing totaling $29.0.

[a] Supplementary financing.

Source: International Development Association.

TABLE F-2.—*IDA credit commitments and disbursements by fiscal years, through June 30, 1976*

[Millions of dollar equivalents]

Fiscal year	Number of credits	Credit commitments	Disbursements
Total	599	10,089	5,718
1976	73	1,655	1,252
1975	68	1,576	1,025
1974	69	1,095	711
1973	75	1,357	493
1972	68	1,000	261
1971	51	584	235
1970	50	606	143
1969	29	385	256
1968	16	107	319
1967	17	354	342
1966	12	284	267
1965	19	309	222
1964	17	283	124
1963	17	260	56
1962	16	134	12
1961	2	101	....

* Includes cancellations, refundings and terminations totaling $95,821,017 and credits approved but not yet effective totaling $697,500,000.

NOTE.—This table does not include the Bangladesh resumption credits in the total amounts of lending, numbers of operations, and cancellations.

Detail may not add to totals due to rounding.

Source: International Development Association.

TABLE F-3.—*Funds available for lending by IDA as of June 30, 1976*

[Millions of dollar equivalents]

Part I countries (100 percent of subscriptions)	910
Part II countries (10 percent of subscriptions)	33
Part II countries (90 percent portion released)	43
Additional subscriptions part I countries	62
Additional subscriptions part II countries	2
Total, subscriptions	1,050
1st replenishment	898
2nd replenishment	1,433
Special supplementary contributions	86
3rd replenishment	2,870
4th replenishment	3,957 *
Total, supplementary resources	9,244
Loans from Swiss Confederation	74
World Bank transfers	1,008
Accumulated net income	83
Participation in credits	18
Grand Total	11,477
Less net commitments	10,442
Funds available for lending as of June 30, 1976	1,035

* Excluding Italy's contributions for which notification has not yet been received, and the Swiss loan also not received by IDA.

Source: International Development Association.

TABLE F-4.—*Estimated IDA effects on U.S. balance of payments from inception of IDA through June 30, 1976*

[U.S. dollars—millions]

	Inception through June 30, 1968	Fiscal year								Inception through June 30, 1976
		1969	1970	1971	1972	1973	1974	1975	1976	
Received by IDA from United States:										
Subscriptions and contributions	492.4	36.3	54.6	37.7	78.1	125.1	230.2	340.6	489.8	1,884.8
Investment income in United States	18.3	3.2	5.5	7.3	9.9	11.8	25.9	26.2	14.1	122.2
Total	510.7	39.5	60.1	45.0	88.0	136.9	256.1	366.8	503.9	2,007.0
Paid by IDA to United States:										
Procurement of goods [1]	234.0	32.0	19.4	45.7	35.1	59.8	87.7	122.6	158.7	795.0
Administrative expenses	18.8	3.6	14.3	18.4	27.5	27.3	39.9	43.7	60.0	253.5
Total	252.8	35.6	33.7	64.1	62.6	87.1	127.6	166.3	218.7	1,048.5
Net received by IDA from United States	257.9	3.9	26.4	(19.1)	25.4	49.8	128.5	200.5	285.2	958.5
Long-term investments in United States [2]	10.0		(10.0)				142.0	(122.0)	(10.0)	10.0
Net received by IDA from United States	247.9	3.9	36.4	(19.1)	25.4	49.8	(13.5)	322.5	295.2	948.5

[1] Includes procurement specifically identifiable as originating in the United States and the same proportion of procurement not identifiable by country of origin.

[2] Maturities over one year.

Source: International Development Association.

SECTION G.—International Finance Corporation

TABLE G–1.—*IFC investment commitments July 1, 1975 to June 30, 1976*
[Millions of dollars]

Country	Total	Loan	Equity	Purpose
Total [1]	245.3	225.5	19.8	
Bolivia	0.6		0.6	DFC
	0.3		0.3	Capital Markets
Brazil	7.5	6.5	1.0	Textiles
	6.0	6.0		Textiles
Colombia	6.0	6.0		Mining
Ecuador	5.0	5.0		Food Processing
Egypt	5.7	4.8	0.9	Cement
India	6.6	6.6		Manufacturing
Indonesia	1.1		1.1	Cement
Israel	7.0	7.0		Chemicals
Kenya	9.1	6.3	2.8	Textiles
Korea	19.0	15.0	4.0	Manufacturing
	17.8	17.8		DFC
	10.4	10.0	0.4	Manufacturing
	5.5	5.0	0.5	Pulp and Paper
	0.4		0.4	Capital Markets
Malawi	6.0	6.0		Textiles
Morocco	1.4		1.4	Cement
Nicaragua	6.5	6.5		Agribusiness
	0.9	0.7	0.2	Tourism
Pakistan	2.2	2.2		Pulp and Paper
Philippines	2.8	2.6	0.2	Manufacturing
Rwanda	0.5	0.5		Agribusiness
Senegal	0.7		0.7	Agribusiness
Sudan	10.0	8.7	1.3	Textiles
Thailand	10.0	10.0		Cement
Turkey	25.0	25.0		DFC
	15.4	12.0	3.4	Steel
	1.6	1.6		Manufacturing
Uruguay	3.8	3.8		Manufacturing
Yugoslavia	50.0	50.0		Steel
Zambia	0.5		0.5	DFC
Regional—Africa	0.2		0.2	DFC

[1] Individual items may not add to total because of rounding.

Source: International Finance Corporation.

TABLE G–2.—*IFC statement of changes in financial position for fiscal year 1976*

[Expressed in U.S. dollars]

Source of resources:	
Net income	7,690,720
Items not requiring current outlay of funds:	
Provisions for losses on investments	6,366,906
Changes in accrued income and expenses	1,128,191
Other	(5,351)
	15,180,466
Capital subscriptions	993,000
Loans from the International Bank for Reconstruction and Development	65,719,008
Repayments of loans	32,675,607
Sales and participations	102,446,888
Other	1,665,943
Total source of resources	218,680,912
Application of resources:	
Disbursements on loans and equity investments	199,703,574
Repayments on loans from the International Bank for Reconstruction and Development	9,634,172
Other	
Total application of resources	209,337,746
Increase in cash and short-term obligations of governments	9,343,166

Source: International Finance Corporation.

TABLE G-3.—*Summary of IFC investments and standby and underwriting commitments as of June 30, 1976*
[Thousands of dollars]

Area, country	Number of investments and standby and underwriting commitments	Operational investments	Standby and underwriting commitments	Total commit-ments
Total	383	1,450,043	55,422	1,505,465
Australia	3	975	....	975
Australia	3	975	....	975
Africa and Middle East	73	206,201	5,630	211,831
Cameroon	1	134	265	399
Egypt	1	5,652	....	5,652
Ethiopia	5	12,053	3,715	15,768
Iran	8	42,536	....	42,536
Israel	2	10,500	....	10,500
Ivory Coast	1	204	....	204
Jordan	2	4,890	....	4,890
Kenya	7	34,948	....	34,948
Lebanon	4	7,280	....	7,280
Liberia	1	....	250	250
Malawi	1	6,000	....	6,000
Mauritania	1	20,007	....	20,007
Mauritius	1	615	....	615
Morocco	3	4,237	....	4,237
Nigeria	7	4,600	1,400	6,000
Rwanda	1	535	....	535
Senegal	5	4,565	....	4,565
Sudan	3	12,188	....	12,188
Tanzania	2	4,657	....	4.657
Tunisia	8	20,688	....	20,688
Uganda	2	4,618	....	4,618
Zaire	1	756	....	756
Zambia	4	3,858	....	3,858
Africa (Regional)	2	680	....	680
Asia	88	373,501	8,746	382,247
Afghanistan	1	322	....	322
China	3	9,844	....	9,844
India	15	58,403	....	58,403
Indonesia	13	59,472	....	59.472
Korea	15	97,188	....	97,188
Malaysia	6	8,201	490	8,691
Nepal	1	3,107	....	3,107
Pakistan	13	30,224	....	30,224
Philippines	15	70,724	8,256	78 980
Sri Lanka	1	3,250	....	3,250
Thailand	5	32,766	....	32,766
Europe	56	328,748	159	328,907
Cyprus	1	2,884	....	2,884
Finland	4	2,989	159	3,148
Greece	8	16,129	....	16,129
Italy	1	960	....	960
Spain	7	18,761	....	18,761
Turkey	25	158,302	....	158,302
Yugoslavia	10	128,723	....	128,723

See footnote at end of table.

TABLE G–3.—*Summary of IFC investments and standby and underwriting commitments as of June 30, 1976*—Continued

[Thousands of dollars]

Area, country	Number of investments and standby and underwriting commitments	Operational investments	Standby and underwriting commitments	Total commit-ments
Western Hemisphere	163	540,618	40,887	581.505
Argentina	10	50,210	3,000	53,210
Bolivia	3	1,187	100	1,287
Brazil	29	275,438	878	276,316
Chile	10	21,191	....	21,191
Colombia	42	35,733	467	36,200
Costa Rica	2	279	311	590
Dominican Republic	1	7,380	....	7,380
Ecuador	6	9,302	....	9,302
El Salvador	2	1,074	....	1,074
Guatemala	2	15,200	....	15,200
Honduras	4	453	....	453
Jamaica	2	3,137	....	3,137
Mexico	20	47,382	22,539	69,921
Nicaragua	3	9,471	....	9,471
Panama	1	1,472	....	1,472
Paraguay	1	5,400	....	5,400
Peru	10	23,980	....	23,980
Uruguay	1	3,800	....	3,800
Venezuela	13	18,529	13,592	32,121
Latin America (Regional)	1	10,000	....	10,000

Source: International Finance Corporation.

TABLE H-1.—*IDB Fund for Special Operations, contribution quotas,*[1] *June 30, 1976*

[Thousands of U.S. dollars]

Country	Contribution quotas
Argentina	224,067
Barbados	806
Bolivia	17,990
Brazil	224,067
Canada [2]	62,652
Chile	61,522
Colombia	61,481
Costa Rica	8,994
Dominican Republic	11,993
Ecuador	11,993
El Salvador	8,994
Guatemala	11,993
Haiti	8,994
Honduras	8,994
Jamaica	11,993
Mexico	144,053
Nicaragua	8,994
Panama	8,994
Paraguay	8,994
Peru	30,010
Trinidad and Tobago	8,994
United States [3]	2,800,000
Uruguay	24,029
Venezuela	120,060
Total	3,890,661

[1] Excluding maintenance of value adjustments of $504,-622,000 resulting from currency devaluations.

[2] Canada will also contribute the repayments of loans made from a fund administered by IDB totaling $74,000,-000. At June 30, 1976, $2,652,000 had been contributed.

[3] A portion of the U.S. contribution is pending appropriation by the U.S. Congress.

Source: Inter-American Development Bank.

TABLE H-2.—*IDB loan approvals—Ordinary Capital resources by country, purpose and terms, July 1, 1975 to June 30, 1976*

Borrowing country—purpose	Amount (millions)	Interest (percent)	Maturity (years)
Total	$585.6		
Argentina:			
Agriculture [1]	5.0	8	20
Industry and Mining	55.0	8	15
Industry and Mining	15.0	Variable	8
Brazil:			
Power	173.0	8	15–20
Education [2]	20.0	8	30
Colombia:			
Industry and Mining	30.0	8	17
Transportation [3]	11.0	8	20
Costa Rica:			
Industry and Mining [4]	5.0	8	20
Ecuador:			
Transportation	11.1	8	20
Guatemala:			
Power [5]	10.0	8	25
Power [5]	15.0	Variable	9
Jamaica:			
Sanitation [6]	5.9	8	20
Export Financing	.5	7	
Mexico:			
Agriculture [7]	159.8	8	18.25
Sanitation	17.0	8	20
Tourism	20.0	8	18
Peru:			
Power	32.3	8	20

[1] Joint OC/FSO financing, totalling $30.0 million equivalent.

[2] Joint OC/FSO financing, totalling $50.0 million equivalent.

[3] Joint OC/FSO financing, totalling $45.8 million equivalent.

[4] Joint OC/FSO financing, totalling $8.0 million equivalent.

[5] Joint OC/FSO/VTF financing, totalling $105.0 million equivalent.

[6] Joint OC/FSO financing, totalling $12.0 million equivalent.

[7] Includes two OC/FSO joint financings, one totalling $41.0 million equivalent, and the other $40.0 million equivalent.

Source: Inter-American Development Bank.

TABLE H-3.—*IDB loan approvals—Fund for Special Operations, by country, purpose and terms, July 1, 1975 to June 30, 1976*

Borrowing country—purpose	Amount (millions)	Interest (percent) [9]	Maturity (years)
Total	$645.4		
Argentina:			
Agriculture [1]	25.0	4	25
Barbados:			
Sanitation	9.7	2	35
Bolivia:			
Agriculture	4.2	1–2	40
Industry and Mining	3.9	1–2	25
Power	24.5	1–2	40
Transportation	45.0	1–2	40
Tourism	2.1	1–2	25
Brazil:			
Agriculture	40.0	4	20
Education [2]	30.0	3	30
Chile:			
Urban Development	25.2	2	30
Colombia:			
Transportation [3]	34.8	2	30
Costa Rica:			
Industry and Mining [4]	3.0	2	20
Power	13.5	2	35
Sanitation	20.0	2	35
Dominican Republic:			
Industry and Mining [5]	7.0	1–2	40
Guatemala:			
Agriculture	15.0	1–2	40
Industry and Mining	4.2	1–2	40
Power [6]	45.0	1–2	40
Sanitation	35.0	1–2	40
Education	8.6	1–2	40
Tourism	2.8	1–2	40
Haiti:			
Transportation	32.5	1–2	40
Sanitation	6.3	1–2	40
Honduras:			
Transportation	14.7	1–2	40
Sanitation	11.5	1–2	40
Jamaica:			
Power	9.2	2	35
Sanitation [7]	6.1	2	35
Education	5.9	2	36
Mexico:			
Agriculture [8]	31.0	3	25
Nicaragua:			
Power	16.5	1–2	40
Panama:			
Transportation	30.0	2	30
Education	12.2	2	30
Paraguay:			
Agriculture	3.2	1–2	40

See footnotes at end of table.

TABLE H-3.—*IDB loan approvals—Fund for Special Operations, by country, purpose and terms, July 1, 1975 to June 30, 1976*—Continued

Borrowing country—purpose	Amount (millions)	Interest (percent) [9]	Maturity (years)
Peru:			
Transportation	37.6	2	25
Central America:			
Transportation	25.0	1–2	30
Regional:			
Preinvestment	5.2	2	31

[1] Joint OC/FSO financing, totalling $30.0 million equivalent.
[2] Joint OC/FSO financing, totalling $50.0 million equivalent.
[3] Joint OC/FSO financing, toalling $45.8 million equivalent.
[4] Joint OC/FSO financing, totalling $8.0 million equivalent.
[5] Joint FSO/Swiss Fund financing, totalling $7.0 million equivalent.
[6] Joint OC/FSO/VTF financing, totalling $105.0 million equivalent.
[7] Joint OC/FSO financing, totalling $12.0 million equivalent.
[8] Includes two OC/FSO joint financings, one totalling $41.0 million equivalent, and the other $40.0 million equivalent.
[9] "1–2" indicates interest at 1% during the grace period and 2% thereafter.

Source: Inter-American Development Bank.

TABLE H-4.—*IDB loan commitments, disbursements, and undisbursed amounts for Ordinary Capital and the Fund for Special Operations, through Dec. 31, 1975*

[Millions of U.S. dollars]

Calendar year	Number of loans	Loan: Commitments	Loan: Disbursements	Loan: Undisbursed accumulated
Total	736	8,000.0	4,452.8	
1975	62	1,280.4	671.5	3,547.2
1974	51	1,090.2	659.7	2,938.3
1973	50	868.2	570.5	2,507.8
1972	48	782.4	464.6	2,210.1
1971	50	533.2	450.1	1,892.3
1961–70	475	3,445.6	1,636.4	1,809.2

NOTE.—Commitments have been adjusted for cancellations and currency exchange rate fluctuations in the years in which the corresponding loans were approved; disbursements have been adjusted for currency exchange rate fluctuations in the years in which such adjustments were recorded. Such adjustments also affect the "Undisbursed" amounts by years.

Source: Inter-American Development Bank.

TABLE H–5.—*Estimated effects of IDB ordinary capital transactions on the U.S. balance of payments, 1960–1975*

[Millions of U.S. dollars]

	Inception through December 31, 1965	Calendar year										Inception through December 31, 1975
		1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	
1. U.S. subscription [1]	75.0	37.5	37.5	...	...	...	...	...	...	29.0	34.8	213.8
2. Net sales of bonds and loan participations in United States	215.0	3.1	86.8	73.6	(5.1)	79.5	(13.7)	(16.0)	(21.2)	(4.9)	204.8	601.9
3. Investment income earned by IDB in United States	34.3	14.8	18.1	21.3	29.1	34.6	28.8	24.3	36.5	45.1	49.5	336.4
4. U.S. payments to IDB	324.3	55.4	142.4	94.9	24.0	114.1	15.1	8.3	15.3	69.2	289.1	1,152.1
5. IDB-financed goods bought in United States [2]	62.9	19.0	22.4	43.0	20.6	33.6	24.6	28.6	33.2	33.6	60.9	382.4
6. Interest paid by IDB to U.S. bondholders and purchases of participations	18.1	10.6	11.9	15.5	19.9	19.3	27.1	27.1	23.3	29.5	39.6	241.9
7. IDB administrative expenses in United States [3]	27.2	8.5	9.3	8.0	8.4	9.6	10.6	11.0	15.0	20.4	22.0	150.0
8. U.S. receipts from IDB (items 5 through 7)	108.2	38.1	43.6	66.5	48.9	62.5	62.3	66.7	71.5	83.5	122.5	774.3
9. Net U.S. payments to (receipts from) IDB	216.1	17.3	98.8	28.4	(24.9)	51.6	(47.2)	(58.4)	(56.2)	(14.3)	166.6	377.8
10. Long-term investments [4]	(101.0)	(81.0)	(105.6)	(50.0)	38.4	2.2	224.0	4.5	(196.8)	39.7	121.1	(104.5)
11. Net U.S. payments to (receipts from) IDB and long-term investments	115.1	(63.7)	(6.8)	(21.6)	13.5	53.8	176.8	(53.9)	(253.0)	25.4	287.7	273.3

[1] Total U.S. subscriptions net of amounts held by IDB in non-negotiable, non-interest bearing notes received from the U.S. on account of its own subscription.
[2] Partly estimated.
[3] Includes payment for real estate and mortgage amortization.
[4] Net changes in IDB holdings in certificates of deposit issued by U.S. banks with maturities of more than 12 months.

Source: Inter-American Development Bank.

TABLE H-6.—*Estimated effects of IDB Fund for Special Operations transactions on the U.S. balance of payments, 1960 to Dec. 31, 1975*

[Millions of U.S. dollars]

1. U.S. subscription:	
Total subscription	3,040.3
Less: Amount not yet received in cash	1,633.2
Total amount received	1,407.1
2. Investment income earned by IDB in United States	19.9
3. U.S. Payments to IDB [1]	1,427.0
4. IDB-financed goods bought in United States via direct purchases	362.7
5. IDB-financed goods bought in United States via special letters of credit	493.5
6. Interest paid by IDB to U.S. purchasers of participations	.2
7. IDB administrative and technical assistance expenses in United States	164.8
8. U.S. receipts from IDB (items 4 through 7	1,021.2
9. Net U.S. payments to IDB	405.8
10. Long-term investments	(2.0)
11. U.S. payments to IDB, net of long-term investments	403.8

[1] Excludes $34.3 million of dollar participations in loans of the Fund for Special Operations sold to the Social Progress Trust Fund.

Source: Inter-American Development Bank.

TABLE H-7.—*IDB borrowings and outstanding issues as of June 30, 1976*

[Millions of U.S. dollars]

[IDB exchange rates as of June 30, 1976]

Currency of issue	Number of issues	Original amount	Outstanding amount	Outstanding issues
Total	95	2,138.2	1,814.6	81
U.S. dollars	41	1,100.5 [1]	936.9	30
Austrian schillings	3	24.6	16.1	3
Belgian francs	2	18.1	15.8	2
British pounds	4	17.5	6.6	3
French francs	2	45.2	42.6	2
German marks	10	325.5	258.8	9
Italian lire	3	65.8	58.0	3
Japanese yen	11	177.3	147.7	11
Netherlands guilders	2	24.6	24.6	2
Spanish pesetas	1	11.9	11.9	1
Swedish kronors	4	24.3	21.3	4
Swiss francs	10	275.5	246.9	9
Trinidad & Tobago dollars	1	4.1	4.1	1
Venezuela bolivars	1	23.3	23.3	1

[1] Only net increases considered in rollover of short-term borrowings.

Source: Inter-American Development Bank.

[Millions of U.S. dollars]

[IDB exchange rates as of June 30, 1976]

Date	Type of issue	Total	New funds	Old funds
Total		352.8	319.1	33.7
1975:				
July 7	8.25 percent 2nd Italian Government loan	25.0	25.0	
October 14	8 percent Swiss franc bonds	24.5	24.5	
December 15	6 percent Finnish loan—seventh issue	.3	.3	
1976:				
January 12	7 percent ECGD line of credit (United Kingdom)	4.0	4.0	
January 20	7.5 percent Swiss franc bonds	30.6	30.6	
February 16	9 percent 25-year U.S. bonds	75.0	75.0	
February 16	8.375 percent 10-year U.S. notes	75.0	75.0	
February 17	8 percent DM bonds	19.6	19.6	
April 12	8 percent 8th line of credit from the Eximbank of Japan	10.0	10.0	
April 12	9.2 percent loan from a Japanese Consortium	6.7	6.7	
April 15	7 percent short-term dollar bonds[1]	33.7		33.7
April 23	7 percent Swiss franc bonds	40.8	40.8	
June 15	6 percent Finnish loan—eighth issue	.1	.1	
June 24	8.25 percent 3rd Italian Government loan	7.5	7.5	

[1] This bond issue was placed with central banks and governmental agencies of Latin American member countries and Israel.

Source: Inter-American Development Bank.

SECTION I.—Asian Development Bank

TABLE I-1.—*Status of contributions to ADB special funds as of June 30, 1976*

[In U.S. dollars] [1]

Contributors	Amounts committed	Amounts made available	Amounts drawn	Resources available for drawing
Multipurpose special fund:				
Australia	10,933,933	10,933,933	10,933,933	....
Canada	8,101,295	8,101,295	8,101,295	....
New Zealand	50,556	50,556	50,556	....
Total	19,085,784	19,085,784	19,085,784	....
Technical assistance special fund:				
Australia	986,280	986,280	986,280	....
Austria	117,242	117,242	117,242	....
Belgium	639,685	639,685	286,710	352,975
Canada	707,461	707,461	707,461	....
China Republic of	200,000	200,000	150,000	50,000
Denmark	880,165	880,165	880,165	....
Finland	117,551	117,551	117,551	....
Germany, Federal Republic of	480,380	480,380	480,380	....
India	218,611	218,611	218,611	....
Italy	145,708	145,708	145,708	....
Japan	11,666,111	11,666,111	11,666,111	....
Korea, Republic of	30,000	30,000	30,000	....
Netherlands	559,255	559,255	419,493	139,762
New Zealand	340,093	340,093	192,330	147,763
Pakistan	64,443	64,443	57,985	6,458
Sri Lanka	20,267	20,267	20,267	....
Switzerland	200,000	200,000	200,000	....
United Kingdom	849,874	849,874	662,972	186,902
United States	1,250,000	1,250,000	1,250,000	....
Total	19,473,126	19,473,126	18,589,266	883,860

[1] Amounts are expressed in the U.S. dollar conversion rate adopted by the Bank as at June 30, 1976.

Source: Asian Development Bank.

TABLE I–2.—*Status of contributions to ADB Asian Development Fund as of June 30, 1976*

[In dollars] [1]

Contributors	Amounts committed [2]	Amounts made available	Amounts drawn	Resources available for drawing
Contributed Resources:				
Australia	22,798,098	22,798,098	22,798,098	....
Austria	2,078,611	2,078,611	....	2,078,611
Belgium	7,025,672	7,025,672	7,025,672	....
Canada	56,142,481	56,142,481	29,501,305	26,641,176
Denmark	8,346,645	8,346,645	6,375,793	1,970,852
Finland	3,603,584	3,603,584	3,603,584	....
Germany, Federal Republic of	75,055,831	75,055,831	58,890,408	16,165,423
Japan	402,110,334	402,110,334	314,821,553	87,288,781
Netherlands	20,917,166	20,917,166	17,153,880	3,763,286
New Zealand	4,948,567	4,948,567	4,948,567	....
Norway	5,825,638	5,825,638	4,012,698	1,812,940
Switzerland	8,100,446	8,100,446	8,100,446	....
United Kingdom	41,990,744	41,990,744	30,813,648	11,177,096
United States	100,000,000	100,000,000	100,000,000	....
Total	758,943,817	758,943,817	608,045,652	150,898,165
Set-Aside Resources	57,433,902	57,433,902	57,433,902	....
Supplementary Resources				
Italy	1,208,108	1,208,108	1,208,108	....
Grand Total	817,585,827	817,585,827	666,687,662	150,898,165

[1] Amounts are expressed in the U.S. dollar conversion rate adopted by the Bank as at June 3, 1976.
[2] Including amounts transferred from the Multi-Purpose Special Fund.

Source: Asian Development Bank.

TABLE I-3.—*Asian Development Bank, ordinary capital resources, loans approved July 1, 1975 to June 30, 1976*

[Millions of dollars]

Country, borrower	Project	Amount	Terms [1] (Years)	Interest (Percent)
Total		668.85		
Hong Kong:				
Government of Hong Kong	Sha Tin Sewage Treatment	20.00	15 (3)	9½
Indonesia:				
Republic of Indonesia	Gohor Lama Palm Oil Processing	11.30	20 (4)	8¾
Do	Karangsambung Multi-Purpose Project	2.90	10 (2)	8¾
Do	Garung Hydroelectric	19.80	25 (4)	8¾
Do	Teluk Lada Area Development	12.20	27 (7)	8¾
Do	Surabaya Institute of Technology	14.50	30 (6)	8¾
Do	Belawan and Surabaya Ports (Phase 1)	4.35	10 (2)	8¾
Do	Maninjau Hydropower	39.70	25 (5)	8¾
Do	Road Improvement	20.00	25 (5)	8¾
Korea, Republic of:				
Republic of Korea	Road Improvement	43.00	23 (3)	8¾
Korea Development Bank	Korea Development Bank (Fourth)	40.00	15 (3)	8¾
Dai Han Coal Corporation	Coal Development	12.00	15 (3)	8¾
Korea Development Finance Corporation	Korea Development Finance Corporation (Second)	40.00	15 (3)	9.10
Malaysia:				
Malaysia	Third Sarawak Electricity Supply	22.70	20 (5)	8¾
Do	Jerangau—Jabor Road	23.70	25 (4)	8¾
Pakistan:				
Islamic Republic of Pakistan	Mirpur Mathelo Fertilizer [2]	38.00	15 (4)	8¾
Industrial Development Bank of Pakistan	Industrial Development Bank of Pakistan (Third)	25.00	15 (3)	8¾
Pakistan Industrial Credit & Investment Corporation	Pakistan Industrial Credit & Investment Corporation (Second)	25.00	15 (3)	9.10
Philippines:				
Republic of the Philippines	Mindanao Secondary and Feeder Roads	0.50	10 (2)	8¾
Do	Laguna de Bay Development	27.50	30 (6)	8¾
Do	Development Bank of the Philippines	25.00	15 (3)	8¾
Do	Provincial Cities Water Supply	16.80	26 (6)	8¾
Do	Philippine National Railways	24.20	20 (5)	8¾
Philippine National Bank	Private Development Corporation of the Philippines (Fourth)	25.00	15 (3)	9.10
Singapore:				
Public Utilities Board	Second Water Supply	23.60	20 (5)	9½
Thailand:				
Industrial Finance Corporation of Thailand	Industrial Finance Corporation of Trailand (Third)	20.00	15 (3)	8¾
Kingdom of Thailand	Fisheries Development	20.00	20 (4)	8¾
Do	Second Highway	19.00	24 (4)	8¾
Metropolitan Electricity Authority	Third Power Distribution	37.00	20 (4)	8¾
Kingdom of Thailand	Southern Land Settlements	16.10	30 (7)	8¾

[1] Inclusive of grace period (shown in parenthesis).
[2] Listed in loans from Special Funds as well as from Ordinary Capital.

Source: Asian Development Bank.

TABLE I-4.—*Asian Development Bank Special Funds resources, loans approved July 1, 1975 to June 30, 1976*

[Millions of dollars]

Country, borrower	Project	Amount	Terms [1] (Years)	Interest (Percent)
Total		213.96		
Afghanistan:				
Kingdom of Afghanistan	Gawargan-Chardarrah Agricultural Development (Supplementary)	10.80	40 (10)	1
Bangladesh:				
People's Republic of Bangladesh	Agricultural Credit	9.43	40 (10)	1
Do	Greater Dacca Gas Distribution	12.20	40 (10)	1
Burma:				
Socialist Republic of the Union of Burma	Jute Mill	25.30	40 (10)	1
Do	Power Transmission (Supplementary)	6.10	40 (10)	1
Do	Sedawgyl Multi-Purpose Dam and Irrigation	45.90	40 (10)	1
Nepal:				
Kingdom of Nepal	Jute Development (Supplementary)	0.53	40 (10)	1
Do	Tribhuvan International Airport	10.00	40 (10)	1
Do	Gandak-Hetauda Power (Supplementary)	2.50	40 (10)	1
Do	Second Power	3.80	40 (10)	1
Pakistan:				
Islamic Republic of Pakistan	Gas Turbine Generation	22.00	40 (10)	1
Do	Mirpur Mathelo Fertilizer [2]	12.00	40 (10)	1
Do	Hyderabad Water Supply & Sewerage	22.00	40 (10)	1
Sri Lanka:				
Republic of Sri Lanka	Urea Fertilizer	30.00	40 (10)	1
Western Samoa:				
Independent State of Western Samoa	Power (Supplementary)	1.40	40 (10)	1

[1] Inclusive of grace period (shown in parenthesis).
[2] Listed in loans from Ordinary Capital as well as from Special Funds.

Source: Asian Development Bank.

TABLE I-5.—*ADB—Ordinary Capital resources loan commitments, disbursements and undisbursed balances from inception through calendar year 1975.*

[Millions of dollars]

Calendar year	Number of loans [1]	Loans: Commitments [2]	Loans: Disbursements [3]	Undisbursed (cumulative)
Total	151	1,844	684	
1975	25	451	285	1,160
1974	27	476	160	994
1973	24	192	120	678
1972	16	200	51	606
1971	17	220	43	457
1970	22	197	16	280
1969	13	66	7	99
1968	7	42	2	40

[1] Excludes loans approved and unsigned.
[2] Net of cancellations but includes loans signed but not yet effective and loans sold or agreed to be sold.
[3] Excludes adjustment in U.S. dollar equivalents of loans disbursed but includes repayment of loans sold.

Source: Asian Development Bank.

TABLE I-6.—*ADB—Special Funds loan commitments, disbursements and undisbursed balances from inception through calendar year 1975.*[1]

[Thousands of dollars]

Calendar year	Number of loans [2]	Loans: Commitments [3]	Loans: Disbursements [4]	Undisbursed (cumulative)
Total	100	656.790	147,944	
1975	15	192,851	76,993	508,846
1974	20	158,326	27,213	392.988
1973	21	104.065	26,188	261,875
1972	16	94,340	10,755	183,998
1971	12	51,510	5,250	100,413
1970	11	39,703	1,470	54,153
1969	5	15,995	75	15,920

[1] Including the Asian Development Fund.
[2] Excludes loans approved and unsigned.
[3] Net of cancellations but includes loans signed but not yet effective.
[4] Excludes adjustment in U.S. dollar equivalents of loans disbursed but includes repayment of loans.

Source: Asian Development Bank.

Table I-7.—*Asian Development Bank—Ordinary Capital resources estimated effect of operations on the U.S. balance of payments from inception of ADB through calendar year 1975*

[In millions of U.S. dollars]

	Calendar years								
	1966-67	1968	1969	1970	1971	1972	1973	1974	1975
Received by ADB from United States:									
Capital subscription	20	10	10	10		[1] 24	[2] 6		[1] 30
Net ADB bond sales in United States					49				74
Net ADB loan sales in United States		1		1	1	(*)	–1	3	1
Investment income in United States	1	2	4	9	12	11	13	15	16
Total	21	13	14	20	62	35	18	18	121
Paid by ADB to United States:									
Procurement of goods				1	3	8	10	19	31
Interest to U.S. bondholders					2	5	4	4	7
Interest to U.S. loanholders						(*)	(*)	(*)	(*)
Administrative expenses	1	1	(*)	(*)	(*)	(*)	[3] 8	[3] 9	[3] 12
Staff retirement plan investments in United States			1	2	2	3	4	5	6
Total	1	1	1	3	7	16	26	37	56
Net receipts to United States [4]	–20	–12	–13	–17	–55	–19	8	19	–65
Long-term investments in United States	21	23	8	–14	23	21	100	67	79
Net effect on liquidity	1	11	–5	–31	–32	2	108	86	14

[1] Includes encashment of demand obligations.
[2] Amount paid in respect of maintenance of value due to the devaluation of the U.S. dollar.
[3] Amounts paid in U.S. dollars but not necessarily spent in the U.S.
[4] Minus sign indicates negative impact on the U.S. balance of payments measured on a liquidity basis.
(*) Less than $500,000.

Source: Asian Development Bank.

Table I-8.—*ADB Borrowings and Outstanding Issues as of June 30, 1976*

[Millions of Dollars]

Currency issue	Number of issues	Original amount [1]	Outstanding amount	Outstanding issues
Total	36	1,045.2	959.0	33
U.S. dollars	10	405.5	340.5	7
Austrian schillings	2	15.3	10.5	2
Belgian francs	1	10.2	10.2	1
Deutsche mark	5	141.4	133.9	5
Italian lire	1	11.7	11.7	1
Japanese yen	6	260.4	254.8	6
Kuwaiti dinars	1	16.9	16.9	1
Luxembourg francs	1	10.2	10.2	1
Netherlands guilders	4	82.2	82.2	4
Saudi Arabian riyal	1	14.4	14.4	1
Swiss francs	4	77.0	73.7	4

[1] Includes amounts receivable under contracts.

Source: Asian Development Bank.

TABLE I-9.—*ADB Gross Borrowings in Fiscal Year 1976* [1]

[Millions of Dollars]

Date		Total	New funds	Old funds
Total		470.8	470.8	....
July 31, 1975	8% Swiss franc, 15-year loan of 1975	24.3	24.3	....
Oct. 2, 1975	8.5% Swiss franc, 5-year notes of 1975	4.1	4.1	....
Nov. 16, 1975	8.5% Deutsche mark, 5-year bonds of 1975	19.6	19.6	....
Nov. 30, 1975	8.875% Dutch guilder, 6-year loan of 1975	18.3	18.3	....
Jan. 15, 1976	8.5% U.S. dollar, 5-year notes of 1976	100.0	100.0	....
Mar. 1, 1976	8% Deutsche mark, 6-year bonds of 1976	39.3	39.3	....
Mar. 1, 1976	8.25% Dutch guilder, 7-year notes of 1976	27.4	27.4	....
Mar. 10, 1976	8.7% Japanese yen, 12-year bonds of 1976	49.8	49.8	....
Mar. 17, 1976	8.8125% U.S. dollar, 5-year loan of 1976	10.0	10.0	....
Mar. 24, 1976	7.75% Swiss franc, 7-year bonds of 1976	32.4	32.4	....
Mar. 29, 1976	8.625% Dutch guilder, 8-year loan of 1976	18.3	18.3	....
Apr. 1, 1976	7.375% U.S. dollar, 2-year bonds of 1976	50.0	50.0	....
Apr. 1, 1976	7.75% Deutsche mark, 7-year bonds of 1976	29.5	29.5	....
Apr. 2, 1976	8.375% Dutch guilder, 8-year loan of 1977	18.3	18.3	....
Apr. 20, 1976	8.5% Deutsche mark, 10-year loan of 1976	29.5	29.5	....

[1] Amounts are expressed in the U.S. dollar conversion rate as adopted by the Bank as at June 30, 1976.

Source: Asian Development Bank.

TABLE I-10.—*Asian Development Bank Special Funds estimated effect of operations on the U.S. balance of payments from inception of ADB through calendar year 1975* [1]

[In thousands of U.S. dollars]

	Calendar years							
	1968	1969	1970	1971	1972	1973	1974	1975
Received by ADB from United States:								
Special Funds contributions	126	112	585	427				
Investment income in United States				136	289	968	1,574	1,281
Total	126	112	585	563	289	968	1,574	1,281
Paid by ADB to United States:								
Procurement of goods			200	303	212	161	292	2,815
Administrative expenses	126	112	1,012					
Total	126	112	1,212	303	212	161	292	2,815
Net receipts to United States			627	−260	−77	−807	−1,282	1,534
Long-term investments in United States						4,000	4,500	1,500
Net effect on liquidity basis			627	−260	−77	3,193	3,218	3,034

[1] Includes the Asian Development Fund established in 1974.

Source: Asian Development Bank.

SECTION J.—Export-Import Bank

TABLE J–1.—*Export-Import Bank authorizations by area in fiscal year 1976*

	Loans	Guarantees	Medium-term insurance	Short-term insurance	Total
Africa	182,335,021	188,291,913	82,654,755	236,811,594	690,093,283
Asia	896,436,474	632,625,608	178,066,133	609,206,314	2,316,334,529
Canada	3,668,061	4,979,232	1,482,255	251,837,247	261,966,796
Europe	693,680,480	259,794,618	66,212,891	1,318,683,896	2,338,371,885
Latin America	469,394,474	532,705,964	365,086,604	1,173,886,022	2,541,073,064
Oceania	39,680,776	3,297,717	13,865,178	208,826,254	265.669,925
Miscellaneous		39,470,339			39,470,339
Total by area	2,285,195,285	1,661,165,391	707,367,816	3,799,251,328	8,452,979,820
Discount loans	1,203,651,607				1,203,651,607
Short term insurance authorized but unshipped:					
Regular				739,231,953	739,231,953
Master Policies				–1,775,934,281	–1,775,934,281
Total authorizations	3,488,846,892	1,661,165,391	707,367,816	2,762,549,000	8,619,929,099

Source: Export-Import Bank of the United States.

TABLE J-2.—*Export-Import Bank authorizations by country in fiscal year 1976*

	Loans	Guarantees	Medium-term insurance	Short-term insurance	Total
Afghanistan				136,353	136,353
Algeria	87,553,338	43,840,386	23,220,000	11,774,256	166,387,980
Angola			1,091,640	1,211,479	2,303,119
Antigua				131,150	131,150
Argentina	5,200,132	3,392,039	6,692,999	53,297,094	68,582,264
Australia	22,029,673	2,756,879	8,692,788	146,937,600	180,416,939
Austria	80,000		125,300	15,548,808	15,754,108
Azores				7,500,437	7,500,437
Bahamas		34,800	−535,432	3,009,007	2,508,374
Bahrain			49,465	3,107,048	3,156,513
Barbados		18,488		−1,156,478	−1,137,990
Belgium	2,250,000		2,695,158	85,608,190	90,553,347
Belize		48,600		1,932,547	1,981,147
Benin, Peoples Republic of				300,267	300,267
Bermuda				6,588,787	6,588,787
Bolivia	4,902,404	6,779,080	10,170,954	3,868,037	25,720,474
Botswana				32,029	32,029
Brazil	132,501,280	78,899,222	28,824,715	165,854,942	406,080,160
Brunei				20,103	20,103
Burma, Union of				370,000	370,000
Burundi				524,783	524,783
Cameroon, Federal Republic of	3,520,686	3,600,000		1,661,434	8,782,120
Canada	3,668,061	4,979,232	1,482,255	251,814,319	261,943.867
Canary Islands				1,549,617	1,549,617
Cape Verde Islands				5,377	5,377
Cayman Islands	2,044,000	938,800	62,923		3,045,723
Central African Republic				695	695
Chad				726	726
Chile	5,560,991	6,654,100	9,146,216	9,392,293	30.753,601
China, Republic of (Taiwan)	78,332,735	24,767,200	641,463	41,357,613	145,099,010
Colombia	6,230,673	19,344,927	13,991,675	76,482,755	116 050,030
Costa Rica	1,140,220	3,539,631	14,063,709	39.046,093	57,789,653
Cyprus				8 619,240	8 619,240
Denmark	12,937,500		684,941	26,063,013	39,685.454
Dominican Republic	23,750,036	17,085,256	5,249,051	25,960.022	72,044,365
Ecuador	1,240,000	18,297,076	27,273,534	51,514,513	98,325.123
Egypt, Arab Republic of				102,000	102,000
El Salvador	6,614,784	6,016,975	2,696,417	26,636.760	41,964.936
Ethiopia				−148,601	−148 601
Faroe Islands				8,819	8,819
Fiji				123,207	123,207
Finland	6,840,000	611,117	745,178	45,139.162	53,335.457
France	15,643,500	14,525,348	2,376,716	173,513.274	206,063 839
French Territory of the Afars and Issas				36,525	36,525
Gabon	6,614,400	1,458,000	87,395	1,529.289	9,689,084
Gambia, The				44,670	44.670
Germany, Federal Republic of	27,570,000	97,100	429,970	197,990.108	226,087,178
Ghana				454,166	454.166
Gibraltar				4,363	4.363
Greece	19,678,810	12,818,161	7,453,390	48,477,597	88,427,959
Greenland				122	122
Guatemala	304,000	5,217,910	8,275,915	25,893.416	39,691.241
Guiana—French				8,159	8.159
Guinea				4,407	4.407
Guyana		3,817,600	81,289	4,493,130	8,392.019
Haiti				1,207 693	1.207 693
Honduras	4,475,220	12,290,845	4.096 372	17,933,966	38.796.403
Hong Kong	1,067,765	590,027	2,828 245	25,828 628	30,314 664
Iceland			248,497	2,055,762	2,304,259

TABLE J-2.—*Export-Import Bank authorization by country in fiscal year 1976*—Continued

	Loans	Guarantees	Medium-term insurance	Short-term insurance	Total
India	1,260,000	2,390,700		−335,946	3,314,754
Indonesia	71,908,980	646,000	1,129,600	20,955,157	94,639,737
Iran	39,999,000	3,144,046	67,688,376	66,815,912	177,647,334
Iraq				3,314,277	3,314,277
Ireland	2,500,000		15,473	5,515,318	8,030,791
Israel	109,046,366	93,190,799	1,019,200	41,755,880	245,012,244
Italy	23,829,145	1,166,492	15,042,485	170,517,944	210,556,066
Ivory Coast, Republic of the	2,492,000	2,032,750	1,620,000	2,609,009	8,753,759
Jamaica	216,418	2,370,326	841,312	19,461,289	22,889,345
Japan	86,445,809	4,229,100	11,342,375	110,128,231	212,145,514
Jordan		41,300	219,357	1,151,265	1,411,923
Kenya			129,356	2,435,653	2,565,010
Khmer Republic				−80,000	−80,000
Korea, Republic of	87,411,607	95,037,831	14,452,500	18,311,821	215,213,759
Kuwait		1,307,970	42,556,241	77,875,932	121,740,144
Laos				10,175	10,175
Lebanon		112,167	390,617	10,156,989	10,659,774
Lesotho				680	680
Liberia	2,580,000	1,802,000	800,000	3,805,840	8,987,840
Libya		180,000	984,135	6,575,148	7,739,283
Liechtenstein				1,360,343	1,360,343
Luxembourg		6,634,600		−915,889	5,718,711
Macao				745	745
Madeira Islands				40	40
Malagasy Republic				2,266,705	2,266,705
Malawi			970,200	599,617	1,569,817
Malaysia, Federation of		1,282,500	10,825,988	10,441,658	22,550,147
Mali				6,758	6,758
Malta				3,154,497	3,154,497
Mauritania		5,764,500	1,759,500	564,664	8 088,664
Mauritius				222,728	222,728
Mexico	175,425,060	155,057,368	127,985,346	287,795,969	746,263.744
Monaco				16,995	16,995
Morocco	22,208,000		527,800	2,332,556	25 068.356
Mozambique		87,703	136,718	4,769,510	4,993,931
Nepal				219	219
Netherlands	9,000,055		2,141,592	126,456,999	137,598,646
New Caledonia				93,229	93,229
New Hebrides				177	177
New Zealand	17.651,104	540.838	5,172,390	59,785,499	83.149 831
Nicaragua	12,376,667	5,488,282	5,901,505	16,590,731	40,357,186
Niger				30,374	30,374
Nigeria	40,319	268,200	3 803.652	45,346,803	49,458.973
Norway	48,844,818	5,230,765	3,966 814	18,522,655	76 565,052
Oman			1,031,400	2,230 951	3,262,351
Pacific Islands—British				645,087	645,087
Pacific Islands—French				65	65
Pakistan	13,440 000	4,046,000	360,000	2,042,814	19,888,814
Panama	4,034,774	28,898,304	12,471,224	33,326.130	78,730,433
Papua New Guinea				311.549	311,549
Paraguay		1,779,421	1,197.759	803.307	3,780.487
Peru	34,175.513	45,432.611	28,580 900	42.848 938	151.037,962
Philippines	295,883.042	378,288 310	648,442	28 761,085	703.580.880
Poland	109,586,631	4,050.000		2,309,478	115,946,109
Portugal		952.000	3,700	15.033,200	15.988.900
Qatar		162,000	4,047,156	2,240 910	6,450,066
Reunion Island				87.704	87,704
Romania	14,873,000	8,373,300		363	23,246,663
Saudi Arabia		4,563,508	9,653,066	54,928,832	69,145,406

TABLE J-2.—*Export-Import Bank authorization by country in fiscal year 1976*—Continued

	Loans	Guarantees	Medium-term insurance	Short-term insurance	Total
Senegal	218,535	1,134,000		1,009,313	2,361,848
Seychelles				1,056	1,056
Sierra Leone	1,000,000		1,774,700	370,081	3,144,781
Singapore			1,573,541	13,908,571	15,482,112
South Africa, Republic of		63,658,114	26,066,101	115,676,694	205,400,909
South West Africa				−100,000	−100,000
Spain	371,960,289	177,915,745	13,769,849	122,596,145	686,242,028
Sri Lanka		2,059,200		18,059	2,077,259
St. Pierre and Miquelon				22,929	22,929
Sudan, The		9,536,500	7,785,355	−946,521	16,375,334
Surinam		517,565		11,087,006	11,604,571
Swaziland				27,110	27,110
Sweden	4,995,896	726,795	581,120	42,512,949	48,816,760
Switzerland			2,549,414	43,625,728	46,175,142
Tahiti				−272,273	−272,273
Tanzania		327,300	446,300	−1,185,193	−411,593
Thailand	38,552,791	962,750	2,086,499	20,462,925	62,064,965
Timor				12,976	12,976
Togo, Republic of				809,684	809,684
Trust Territory Pacific Islands (United States)				1,177,637	1,177,637
Trinidad and Tobago	29,925,300	10,316,993	1,429,501	9,470,285	51,142,079
Tunisia	8,374,400	1,988,900		606,938	10,970,238
Turkey	70,245,200	15,804,200	5,266,100	14,736,478	106,051,978
Uganda				9,122	9,122
United Arab Emirates	2,843,180		256,500	37,981,965	41,081,645
United Kingdom	1,200,000	514,180	4,794,694	152,858,887	159,367,761
Upper Volta	1,000,000	488,000		310,691	1,798,691
Uruguay		1,644,800	1,795,190	5,635,632	9,075,622
Venezuela	19,277,000	97,851,731	54,929,416	221,554,157	393,612,304
Vietnam, Republic of				537,500	537,500
Virgin Islands—British		872,400		159,304	1,031,704
West Indies—British			18,400	2,534,634	2,553,034
West Indies—French		10,814	219,958	7,312,704	7,543,476
West Indies—Netherlands		90,000	−374,243	3,212,050	2,927,807
Western Samoa				24,477	24,477
Yemen Arab Republic				21,188	21,188
Yugoslavia	21,890,836	26,179,013	8,588,600	4,584,349	61,242,798
Zaire	45,345,843	45,345,860	14,747	10,707,518	101,413,968
Zambia	1,387,500	6,779,700	11,437,156	18,778,233	38,382,589
Various Countries—Unallocable		39,470,339			39,470,339
Total by country	2,285,195,285	1,661,165,391	707,367,816	3,799,251,328	8,452,979,820

Source: Export-Import Bank of the United States.

TABLE J-3.—*Export-Import Bank comparative statement of changes in financial position*

	Fiscal year ended June 30, 1976	June 30, 1975
Funds provided:		
Net income	$115,500,000	$80,500,000
Borrowings from the U.S. Treasury and the Federal Financing Bank	2,285,000,000	4,049,400,000
Borrowings from the Private Export Funding Corporation	100,000,000	0
Repayments and Other Credits to Loans Receivable	1,363,200,000	1,359,300,000
Accrued Interest Payable	17,400,000	16,300,000
Sales of Certificates of Beneficial Interest	9,500,000	0
Other	38,200,000	(10,200,000)
Total funds provided	3,928,800,000	5,495,300,000
Funds applied:		
Disbursements and Other Additions to Loans, includes Capitalized Interest—1976, $7,490,291; 1975, $4,191,572	2,310,900,000	2,818,700,000
Investment in U.S. Securities	9,600,000	0
Accrued Interest and Fees Receivable	42,200,000	35.000,000
Redemptions of Certificates of Beneficial Interest	0	41,800 000
Redemptions of Debentures and Participation Certificates	0	300,000.000
Payment of Dividend to U.S. Treasury (F/Y 1975 and F/Y 1974)	20.000,000	50,000,000
Repayments to F.F.B.	1,349,800.000	0
Repayments to Treasury	196,300,000	2,249,800 000
Total funds applied	3,928,800,000	5,495,300,000

Source: Export-Import Bank of the United States.

SECTION K.—Agency for International Development

TABLE K-1.—*AID development loan authorizations, July 1, 1975 to June 30, 1976, by area, country, terms and purpose*

[In millions of U.S. dollars]

Area and country	Amounts	Government: Interest rate or fee	Government: Maturity (years)	Government: Grace period (years)	Subborrowers: Interest rate or fee	Subborrowers: Maturity (years)	Subborrowers: Grace period (years)	Purpose
Total all areas	1,181.3							
Africa–Sub-total	82.6							
Morocco—Government	13.0	2–3	40	10				Doukkala irrigation.
Portugal—Government	8.0	5	25	5				Basic sanitation.
Portugal—Government	11.0	5	25	5				School construction.
Tanzania—Government	3.9	2–3	40	10				Tan Zam highway construction.
Zaire—Government	10.0	2–3	40	10				Commodity financing.
CWAORA—Council of Entente States	4.5	2–3	40	10				Livestock II.
CWAORA—Council of Entente States	8.0	2–3	40	10				Food production.
Botswana—Government	1.0	4	40	10				Northern Abattoir design.
Kenya—Government	5.0	2–3	40	10				Agriculture sector II.
Gabon—Government	5.0	2–3	40	10				Access roads
Ghana—Government	10.0	2–3	40	10				MIDAS — Small farmer development.
Mali—Government	3.2	2–3	40	10				Highway development—road equipment.
Asia–Subtotal	901.8							
Korea—Government	5.0	2–3	40	10				Health demonstration.
Korea—Government	5.0	2–3	40	10				Standards Research Institute.
Korea—Government	5.0	2–3	40	10				National University Program of Natural Sciences.
Philippines—Government	10.0	2–3	40	10				Bicol River Basin secondary and feeder roads.
Philippines—Government	2.0	2–3	40	10				Third feasibility studies.
Philippines—Government	5.0	2–3	40	10				Agricultural research loan.
Philippines—Government	20.0	2–3	40	10				Rural electrification IV.
Philippines—Government	20.0	2–3	40	10				Local water development.
Indonesia—Government	5.0	2–3	40	10				Technical assistance/consulting services.
Indonesia—Government	12.5	2–3	40	10				Citanduy basin development project.
Indonesia—Government	5.5	2–3	40	10				Agriculture education for development.
Indonesia—Government	6.8	2–3	40	10				Rural sanitation manpower development.
Indonesia—Government	5.0	2–3	40	10				Higher education and development training.
Jordan—Government	1.0	2–3	40	10				Feasibility study—Magarin Dam.

See footnote at end of table.

TABLE K-1.—*AID development loan authorizations, July 1, 1975 to June 30, 1976, by area, country, terms and purpose*—Continued

[In millions of U.S. dollars]

Area and country	Amounts	Government			Subborrowers			Purpose
		Interest rate or fee	Maturity (years)	Grace period (years)	Interest rate or fee	Maturity (years)	Grace period (years)	
Jordan—Government	6.0	2–3	40	10				Feasibility study — potash.
Jordan—Government	7.0	2–3	40	10				School construction program.
Syria—Government	14.5	2–3	40	10				Second Damascus water supply.
Syria—Government	17.0	2–3	40	10				Euphrates basin irrigation maintenance.
Syria—Government	45.9	2–3	40	10				Damascus to Deraa Road construction.
Bangladesh—Government	2.0	2–3	40	10				Karnaphuli third unit.
Bangladesh—Government	14.0	2–3	40	10				Small scale irrigation I.
Bangladesh—Government	4.0	2–3	40	10				Agriculture research.
Egypt—Government	96.0	2–3	40	10				Misr spinning and weaving (Mehalla).
Egypt—Government	100.0	2–3	40	10				Basic import and production loan III.
Egypt—Government	31.0	2–3	40	10				Alexandria port equipment.
Egypt—Government	50.0	2–3	40	10				Helwan and Talka Gas Turbine Plants.
Egypt—Government	32.0	2–3	40	10	8	20	3	Industrial Development Bank investments and strengthening.
Israel—Government	250.0	2–3	40	10				Commodity import loan.
Greece—Government	65.0	5	25	5				Basic imports and production.
Pakistan—Government	7.5	2–3	40	10				On-farm water management.
Pakistan—Government	40.0	2–3	40	10				Agriculture inputs.
Pakistan—Government	2.5	2–3	40	10				Technical services.
Sri Lanka—Government	4.2	2–3	40	10				Rice research.
Sri Lanka—Government	5.4	2–3	40	10				Paddy storage and processing.
Latin America—Subtotal	196.9							
Colombia — Accion Cultural Popular ("ACPO")	2.0	2–3	40	10				Small farmer training.
Colombia—Servicio Nacionalde Aprendizaji ("SENA")	2.0	2–3	40	10				Small farmer training.
Colombia—Instituto Colombia Agrapecuario ("ICA")	3.4	2–3	40	10				Small farmer development.
Colombia—Government	5.0	2–3	40	10				Small farmer market access.
Colombia—Government	4.0	2–3	40	10				Small farmer training.
Colombia—Government	6.0	2–3	40	10				Nutrition.
Dominican Republic — Government	4.8	2–3	40	10				Health sector.
Dominican Republic — Government	15.0	2–3	40	10				Agricultural sector loan II.

See footnote at end of table.

TABLE K-1.—*AID development loan authorizations, July 1, 1975 to June 30, 1976, by area, country, terms and purpose*—Continued

[In millions of U.S. dollars]

Area and country	Amounts	Government: Interest rate or fee	Government: Maturity (years)	Government: Grace period (years)	Subborrowers: Interest rate or fee	Subborrowers: Maturity (years)	Subborrowers: Grace period (years)	Purpose
Chile—Government	14.0	2–3	40	10				Agriculture production credit.
LA Region—Caribbean Development Bank	10.0	2–3	40	10				Integrated agricultural development.
LA Regional—LAAD	6.0	2–3	20	5				Agribusiness development.
LA Regional—COLAC	4.0	2–3	30	10				Credit union development.
Haiti—Government	5.0	2–3	40	10				Agricultural feeder roads.
Bolivia—Government	8.5	2–3	40	10				Rural access roads.
Bolivia—Government	4.9	2–3	40	10				Education.
Bolivia—Government	7.5	2–3	40	10				Small farmer organizations.
Guatemala—Government	8.0	2–3	40	10				Municipal earthquake recovery.
Guatemala—Government	3.5	2–3	40	10				Property tax development.
Guatemala—Government	13.0	2–3	40	10				Small farmer development.
Honduras—Government	3.5	2–3	40	10				Nutrition.
Honduras—Government	9.5	2–3	40	10				Hurricane rural reconstruction.
Nicaragua—Government	10.0	2–3	40	10				Managua urban reconstruction center.
Nicaragua—Government	5.0	2–3	40	10				Rural health services.
Peru—Government	11.0	2–3	40	10				Sierra water and land use improvement.
Guyana—Government	1.8	2–3	40	10				New Amsterdam approach Canje Bridge Amendment.
Panama—Government	11.0	2–3	40	10				Education sector II.
Panama—Government	4.0	2–3	40	10				Rural municipal development.
Panama—Government	6.0	2–3	40	10				Rural health delivery services.
Paraguay—Government	2.5	2–3	40	10				Rural enterprises.
Costa Rica—Government	6.0	2–3	40	10				Nutrition program.

Source: Agency for International Development.

SECTION L.—Overseas Private Investment Corporation

TABLE L–1.—*Investment insurance issued in fiscal year 1976*

[In millions of dollars]

Maximum coverage

Area	Percent	Total	Type of coverage		
			Incon-vertibility	Expropria-tion	War risk
All areas	100	1,221.9	452.0	502.7	267.1
Latin America	30.8	376.8	166.7	165.4	44.6
East Asia	53.0	648.2	200.0	272.9	175.2
Africa	8.4	102.8	35.8	34.8	32.2
Near East and South Asia	5.8	71.3	26.6	29.6	15.0
Others	2.0	22.8	22.8		

Source: Overseas Private Investment Corporation.

TABLE L–2.—*OPIC total insurance outstanding as of June 30, 1976*

[In millions of dollars]

Maximum coverage

Area	Percent	Total	Type of coverage		
			Incon-vertibility	Expropria-tion	War risk
All areas	100	11,904.0	3,977.5	4,391.5	3,535.0
Latin America	41.9	4,983.9	1,565.4	1,910.5	1,507.9
East Asia	35.1	4,173.6	1,384.5	1,485.9	1,303.2
Africa	10.5	1,251.1	449.9	478.1	323.0
Near East and South Asia	11.6	1,384.7	518.7	486.2	379.9
Others	.9	110.8	59.0	30.8	20.9

Source: Overseas Private Investment Corporation.

TABLE L-3.—*OPIC finance portfolio activity by region in fiscal year 1976*

[In millions of dollars]

Area	Percent	Total	Direct investment fund	Invest-ment guaranty
All areas	100	27.8	10.8	17.0*
Latin America	34.5	9.6	5.6	4.0*
Africa	59.0	16.4	3.4	13.0*
East Asia	1.8	.5	.5	....
Near East and South Asia	4.7	1.3	1.3	....

* Commitments.

Source: Overseas Private Investment Corporation.

TABLE L-4.—*OPIC total finance portfolio outstanding by region as of June 30, 1976*

[In millions of dollars]

Area	Percent	Total	Direct investment fund [1]	Invest-ment guaranty [2]
All areas	100	231.2	31.0	200.2
Latin America	19.0	43.9	15.2	28.7
Africa	15.6	36.1	9.4	26.7
East Asia	57.1	132.1	4.7	127.4
Near East and South Asia	8.3	19.1	1.7	17.4

[1] Original loan amounts less participation.
[2] Includes guaranteed participations in OPIC direct loans.

Source: Overseas Private Investment Corporation.

SECTION M.—Department of Agriculture

TABLE M-1.—*Public Law 480, convertible local currency credit sales agreements and amendments to agreements signed July 1, 1975 to June 30, 1976*

Country	Commodity	Market value (million U.S. dollars)	Credit period [1] Total (years)	Credit period [1] Years before 1st payment due	Interest rate percent [2]
Total		576.3			
Bangladesh	Wheat/wheat flour, rice, soybean/cottonseed oil	90.7	40	10	3
	Wheat/wheat flour, rice, soybean/cottonseed oil	37.9	40	10	3
	Wheat/wheat flour, rice	36.0	40	10	3
Guinea	Wheat flour, rice, soybean oil	5.5	24	6	3
Haiti	Wheat/wheat flour, edible vegetable oil	5.2	40	10	3
India	Wheat/wheat flour, rice	83.0	40	10	3
Indonesia	Wheat/wheat flour, rice	35.2	25	6	4
	Rice	9.8	25	6	4
	....do	14.6	25	6	4
Korea	Rice	18.2	40	10	3
	Wheat/wheat flour, rice	44.7	40	10	3
	Wheat/wheat, rice, cotton	60.0	40	10	3
Morocco	Wheat/wheat flour	14.8	25	3	3
Pakistan	Wheat/wheat flour	45.7	40	10	3
	Wheat/wheat flour, soybean/cottonseed oil	45.6	40	10	3
Sri Lanka	Wheat/wheat flour	22.0	40	10	3
Tanzania	Corn/grain sorghum	4.5	40	10	3
Tunisia	Wheat/wheat flour	2.9	24	3	3

[1] Payments made in approximately equal annual installments.

[2] Interest rate after first payment of principal due. The rate prior to this is usually 2 percent.

Source: Department of Agriculture.

TABLE M-2.—*Public Law 480, dollar credit sales agreements and amendments to agreements signed July 1, 1975 to June 30, 1976*

Country	Commodity	Market value (million U.S. dollars)	Credit period [1] Total (years)	Credit period [1] Years before 1st payment due	Interest rate percent [2]
Total		337.6			
Chile	Wheat/wheat flour	45.7	20	2	3
	....do	3.4	20	2	3
Egypt	Wheat/wheat flour, tobacco/tobacco products	98.1	20	2	3
	Wheat/wheat flour	76.2	20	2	3
	Wheat/wheat flour	28.6	20	2	3
Ethiopia	Wheat/wheat flour	3.6	20	2	3
Honduras	Wheat/wheat flour	2.2	20	2	3
Israel	Wheat/wheat flour	15.2	20	2	3
Jordan	Wheat/wheat flour	6.1	20	2	3
	....do	3.0	20	2	3
	....do	3.1	20	2	3
Portugal	Rice	15.0	15	1	4½
	Cotton	5.0	15	1	4½
Syrian Arab Republic	Rice	11.9	20	2	3
	Tobacco/tobacco products, soybean/cottonseed oil	7.5	20	2	3
Zaire	Rice	8.0	19	1	3
	Cotton	5.0	19	1	3

[1] Payments made in approximately equal annual installments.

[2] Interest rate after first payment of principal due. The rate prior to this is usually 2 percent.

Source: Department of Agriculture.

TABLE M-3.—*Lines of credit approved on 36 month terms under the CCC export credit program during fiscal year 1976*

[In millions of dollars]

Country Commodity	Value of FY 76 Authorizations
Bolivia	9.2
Wheat	9.2
China—Taiwan	3.0
Cotton	3.0
Costa Rica	1.0
Breeding cattle and swine	1.0
Cyprus	7.0
Barley	4.0
Wheat	1.0
Corn/Sorghum	2.0
Dominican Republic	20.0
Dry edible beans	3.7
Vegetable oil	6.4
Wheat	5.7
Feed grains	1.5
Rice	2.7
Greece	45.0
Corn	40.0
Barley	5.0
Indonesia	43.0
Cotton	13.8
Wheat	29.2
Korea	96.5
Cotton	95.0
Breeding cattle	1.5
Morocco	43.0
Wheat	43.0
Pakistan	24.6
Vegetable oil	24.6
Peru	28.0
Wheat	16.0
Corn	6.0
Vegetable oil	6.0
Philippines	20.2
Tobacco	20.2

See footnote at end of table.

TABLE M–3.—*Lines of credit approved on 36 month terms under the CCC export credit program during fiscal year 1976*—Continued

[In millions of dollars]

Country Commodity	Value of FY 76 Authorizations
Poland	137.8
Wheat	25.0
Feed Grains	40.0
Cotton	10.0
Rice	2.8
Soybeans	7.25
Soybean Meal	46.0
Soy-Protein	3.0
Vegetable Oils	3.75
Portugal	50.0
Corn	21.3
Sorghum	6.0
Wheat	6.0
Soybeans	16.7
Romania	47.0
Soybeans	22.0
Soybean Meal	25.0
South Africa	.05
Breeding cattle	.05
Spain	3.0
Breeding cattle	3.0
Thailand	40.0
Tobacco	40.0
West Indies	.1
Breeding cattle	.1
Yugoslavia	38.5
Soybean and products	38.5
Zaire	10.0
Rice	8.0
Tobacco	2.0
Grand Total	667.0

Source: Department of Agriculture.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITEE ON FOREIGN OPERATIONS OF THE SENATE APPROPRIATIONS COMMITTEE
THURSDAY, FEBRUARY 10, 1977, AT 2:00 P.M., EST

Mr. Chairman and Members of the Committee:

1. I am delighted to have this opportunity to begin the testimony of the Carter Administration on foreign assistance policy before the Congress. I hope that today's hearing will commence a close working relationship between the Administration and the Congress in this policy area, as do Secretary Blumenthal and indeed President Carter himself.

2. Close consultation with the Congress will be a hallmark of our approach. The President, in developing the domestic economic recovery program, has already demonstrated his commitment to work intimately with the Congress on all key issues. He extended that approach to the foreign policy area, even before Inauguration Day, through the full-day meeting at the Smithsonian in which you participated, Mr. Chairman, and at which extensive views on the topic now before us were exchanged. It is an honor for me to be able to intensify that commitment today.

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3. In preliminary discussion with the staff of this Committee, and through conversations with yourself and others in the Congress, I believe that progress has already been made toward resolving some of the major issues which have been outstanding in the recent past.

4. First, we fully accept your view that U.S. contributions to the international development lending institutions be pledged "subject to appropriations." I have so informed the management of the World Bank, which is already at work on the adjustments that may therefore be required in their previous operating procedures, and will convey this position clearly to all other donor countries. This is not the time to discuss in detail the forthcoming fifth replenishment of the International Development Association ("IDA V"), which the Administration strongly supports and which we believe will be promoted by the development of a common view between the Administration and the Congress on this important issue. I should note, however, that we welcome the opportunity to have formal hearings, before both your Committee and its companion Committee in the House of Representatives, <u>prior</u> to determining and indicating our contribution to that particular operation.

5. Second, we will initiate a full review of the lending policies and practices, and the internal administration, of all international development lending institutions of which the United States is a member. As President Carter has indicated on several occasions, and as Secretary Blumenthal affirmed in his confirmation hearings before the Senate Finance Committee, this Administration strongly supports the extension of foreign assistance through international development lending institutions.

But, in keeping with the priority which the Administration attaches to efficiency in management and minimization of administrative costs, we will look carefully at all aspects of the banks' operations and report our findings to you as soon as our analyses can be completed. The Treasury Department will attach very high priority to this review. And we will appoint U.S. Executive Directors to each of these institutions who will forcefully convey U.S. policy to them.

6. Third, we accept the proposal in your letter of February 2 to Secretary Blumenthal, co-signed by Chairman Clarence Long of the House Subcommittee, that the fiscal year 1978 budget submission should seek appropriation of all callable capital for the international financial institutions. We have already informed the Office of Management and Budget of our desire to thereby revert to the traditional approach to this issue.

7. Hence we believe that we are moving toward a firm partnership with the Congress in this important policy area. In that vein, we note with pleasure your comment in that same letter to Secretary Blumenthal, Mr. Chairman, that "Congressional support for the development finance proposals of the Executive Branch will be enhanced" by a commitment such as we have just made. We are also heartened that the Budget Committees of both the House and Senate, after contemplating cuts in the appropriations under consideration today, have decided to include the full amounts in their Third Concurrent Resolution. We sincerely hope that these several expressions of support for the program do indeed presage a new period of the closest cooperation between us, beginning with these supplementary appropriations for

fiscal 1977 and continuing into the appropriations for fiscal 1978, which we will be discussing with you informally in the days immediately ahead and more formally in hearings next month.

8. President Carter has personally and publicly indicated his strong support for the legislation before you today. Speaking to a news conference in Plains, after a half-day session on the whole range of international economic issues last August 18, he stressed his firm believe that the United States should make its full contribution to the ongoing activities of the Inter-American Development Bank, the Asian Development Bank, and IDA -- the appropriations which we seek today. President Ford also indicated his full support for these appropriations by including them in his final budget proposals.

9. We fully recognize that these contributions may have been negotiated without the full consultations with the Congress to which the Carter Administration is committed. Nevertheless, the President feels that it is incumbent on the United States to contribute its fair share to those operations. The United States cannot be viewed as a credible and dependable force in world affairs if it does not do so. Hence the Administration urges you to approve the proposed contributions, all of which have, of course, been fully authorized by the Congress and included in the budget resolutions. But I stress to you, again, that all future U.S. participation in international funding activities will take place only after the closest consultation with the Congress, with the firm intention of avoiding any repetition of such circumstances.

10. Today we seek appropriations of $540 million. Only $340 million would be expected to produce budget outlays, spread over a period of several years as the funds are actually expended by the several institutions. The appropriations sought, listed in order of the magnitudes involved, include:

-- $240 million for the second U.S. installment to the current replenishment of the Inter-American Development Bank resources ($40 million for paid-in inter-regional capital and $200 million in ordinary callable capital);

-- $200 million for the first installment of the replenishment of the IDB's Fund for Special Operations;

-- $55 million for the fourth replenishment of the International Development Association ("IDA IV"):

-- $25 million to complete the U.S. contribution to the initial resource mobilization of the Asian Development Fund.

-- $20 million in paid-in inter-regional capital for the first U.S. installment of the current capital replenishment of the Inter-American Development Bank.

11. As you can see, most of the funds requested in the supplemental -- $460 million -- are for the Inter-American Development Bank. These funds are being requested in a FY 1977 supplemental because they are needed by the Bank

before FY 1978 appropriations would become available, to permit continuation of the needed flow of commitments to borrowers in Latin America. Unless the United States makes this money available soon, the Bank will be forced to drastically curtail, or perhaps even halt, its lending operations. In addition, no further subscriptions from other countries will become effective until the United States acts. And this arrangement is necessary to prevent the U.S. vote from falling below 34.5 percent, thereby causing the United States to lose its veto in the Fund for Special Operations.

12. The Inter-American Development Bank has in fact exhausted its hard currency resources available for ordinary loan commitments. In the Fund for Special Operations, in addition, resources are available for anticipated operations only through April. All other member countries have fully subscribed to the first installment, but the United States subscription is essential to make it effective since it requires no less than 75 percent of the total contribution before the installment can be committed.

13. The $55 million appropriation request for IDA would bring up-to-date the U.S. contribution to the fourth replenishment of that institution. IDA is central to our multilateral development strategy, and this contribution is needed to show our good faith and full support for the Association.

14. The FY 1977 supplemental bill also contains $25 million to complete the $150 million U.S. contribution to the initial resource mobilization of the concessional Asian Development Fund. As of today, that Fund has only $42 million available for new loan commitments to its poorest Asian members. Most other donors have completed their contributions to the 1973-1975 resource mobilization of the Fund, and have made their first contributions to the 1976-1978 ADF replenishment. But further contributions from these donors will, under the current replenishment resolution, not become available to the Fund until the United States makes the contribution requested in the FY 1978 appropriations bill. Since this would not occur until after October 1, the $25 million being requested for the ADF in the FY 1977 supplemental bill is likely to be the ADF's only new source of funds over the next six months.

15. Mr. Chairman and Members of the Committee, the Carter Administration strongly supports these proposed contributions to the international lending institutions. We believe that development of the poorer countries is of utmost importance to U.S. security, political and economic interests. We believe that foreign assistance can play a vital role in promoting development. We believe that the international development lending institutions are an extraordinarily valuable instrument for channeling such assistance. The President will be addressing these issues personally, on a number of occasions, over the coming months. We urge you to support the funding requests which are under discussion today, and we look forward to an early opportunity to discuss with you, in depth, the whole array of underlying issues.

16. We are also requesting today an appropriation of $30 million in Israeli pounds for the U.S. contribution to the endowment of the Israel-U.S. Binational Industrial Research and Development Foundation. The Foundation's endowment will be created by contributions of $30 million in Israeli pounds from each government. The United States share will be derived from simultaneous prepayment by Israel of a portion of its PL-480 local currency debt to us. There will be no dollar outlay. An appropriation is necessary for the United States to participate, however, because Israel is no longer an excess currency country.

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partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: L.F. Potts
Extension: 2951
February 9, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES TENTATIVE DETERMINATION TO MODIFY OR REVOKE DUMPING FINDING WITH RESPECT TO CAST IRON SOIL PIPE FROM POLAND

Acting Assistant Secretary of the Treasury John H. Harper announced today the "Tentative Determination to Modify or Revoke Dumping Finding" with respect to soil pipe from Poland. Notice of this action will appear in the Federal Register of February 10, 1977.

The "Finding of Dumping" in the instant case was published in the Federal Register of November 2, 1967.

Before a tentative modification or revocation of a dumping finding can be issued, Treasury requires that the finding have been in effect for at least two years, that there be established a two-year period of no sales at less than fair value subsequent to the finding, and that price assurances be submitted. After an allowance for oral and written presentations, Treasury will then consider whether to issue a final modification or revocation.

Imports of cast iron soil pipe from Poland during the period January through September 1976 were valued at $30,000.

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partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: Robert Standard
Extension: 2951
February 10, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES
FINAL COUNTERVAILING DUTY DETERMINATION
ON SCISSORS AND SHEARS
FROM BRAZIL

The Treasury Department announced today a final determination under the Countervailing Duty Law (19 U.S.C. 1303), that bounties or grants are being paid or bestowed on imports of scissors and shears from Brazil. Notice to this effect will be published in the FEDERAL REGISTER of February 11, 1977.

The Countervailing Duty Law requires the Secretary of the Treasury to assess an additional (countervailing) duty that is equal to the size of the bounty or grant that has been paid or bestowed on the production or exportation of the merchandise. The Department's investigation showed that programs subject to the countervailing duty determination are the overrebate or remission of "IPI" and "ICM" taxes, the exemption of export earnings from income tax and preferential financing. Because the Department was not able to obtain information about an alleged exemption from import duty and certain indirect taxes on imported capital goods used in the production of scissors and shears, a final countervailing duty rate was not determined. The Department has therefore declared an estimated countervailing duty rate of 17 percent, which takes into account the bounty or grant that may be found to exist on the one subsidy program for which there is not sufficient information. The liquidation of entries will be suspended pending the receipt and evaluation of additional information and the estimated duty will be collected in the interim. Programs determined not to be bounties or grants within the meaning of the law included the exemption from certain indirect taxes upon the export of the scissors and shears, and the exemption from import duties and certain indirect taxes on the importation of raw materials used in the production of scissors and shears for export.

Imports of the subject merchandise from Brazil during the first 9 months of 1976 were valued at about $664,000.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: Robert M. Standard
Extension: 2951
February 10, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES REOPENING OF
COUNTERVAILING DUTY INVESTIGATION
AGAINST FOOTWEAR FROM ARGENTINA

The Treasury Department announced today that it will reopen its countervailing duty investigation on non-rubber footwear from Argentina. Announcement of this action will be published in the FEDERAL REGISTER of February 11, 1977.

Under the U.S. Countervailing Duty Law, the Secretary of the Treasury is required to assess an additional (countervailing) duty equal to the amount of the bounty or grant that has been found to be paid or bestowed on the imported merchandise. This action is taken on the basis of new information that indicates that the Argentine Government has recently again begun the payment of an export subsidy on footwear. One year ago the Treasury Department published a final negative determination on Argentine footwear imports when the subsidy then being paid was eliminated.

A preliminary determination as to the existence or nonexistence of a bounty or grant must be made by no later than May 15, 1977. A final determination must be issued no later than December 15, 1977.

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partment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

CONTACT: George G. Ross
202-566-5985
February 11, 1977

FOR IMMEDIATE RELEASE

SECOND PROTOCOL TO THE UNITED STATES AND UNITED KINGDOM INCOME TAX TREATY

The United States Treasury Department today released the text of a proposed second Protocol to the new income tax treaty between the United States and the United Kingdom. A copy of the text of the Protocol is attached. The text has been agreed to at official level, subject to approval by the respective governments.

The treaty was signed by both governments on December 31, 1975 and was amended by Notes exchanged on April 13, 1976. An earlier Protocol was signed by both governments on August 26, 1976. The treaty, as amended, and the earlier Protocol, have been approved by the United Kingdom House of Commons and have been submitted to the United States Senate for its advice and consent to ratification.

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SECOND PROTOCOL

AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AND THE GOVERNMENT OF THE UNITED STATES OF AMERICA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS SIGNED AT LONDON ON 31 DECEMBER 1975, AS AMENDED BY NOTES EXCHANGED AT LONDON ON 13 APRIL 1976 AND BY A PROTOCOL SIGNED AT LONDON ON 26 AUGUST 1976

The Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America;

Desiring to conclude a second Protocol to amend the Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, as amended by Notes exchanged at London on 13 April 1976 and by a Protocol signed at London on 26 August 1976 (hereinafter referred to as "the Convention");

Have agreed as follows:

ARTICLE I

Paragraph (4)(a) of Article 1 (Personal Scope) of the Convention shall be deleted and replaced by the following:

"(a) paragraph (4) of Article 4 (Fiscal Residence), paragraph (2) of Article 8 (Shipping and Air Transport), and Articles 9 (Associated Enterprises), 23 (Elimination of Double Taxation), 24 (Non-discrimination), and 25 (Mutual Agreement Procedure); and"

ARTICLE II

Paragraph (4) of Article 4 (Fiscal Residence) of the Convention shall be renumbered as paragraph (5) and a new paragraph (4) shall be added, to read as follows:

"(4) a marriage before 1 January 1974 between a woman who is a United States national and a man domiciled within the United Kingdom shall be deemed to have taken place on 1 January 1974 for the purpose of determining her domicile on or after 6 April 1976 for United Kingdom tax purposes."

ARTICLE III

Paragraph (1) of Article 22 (Other Income) of the Convention shall be deleted and replaced by the following:

"(1) Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State. The preceding sentence shall not apply to income paid out of trusts."

ARTICLE IV

Sub-Paragraph (3)(e) of Article 25 (Mutual Agreement Procedure) of the Convention shall end with a semi-colon and the following sub-paragraph shall be added:

"(f) the elimination of double taxation in respect of income paid out of trusts."

ARTICLE V

Clauses (ii), (iii) and (iv) of subparagraph (2)(a) of Article 28 (Entry into Force) of the Convention shall be renumbered as clauses (iii), (iv) and (v), respectively, and a new clause (ii) shall be added, to read as follows:

"(ii) in relation to paragraph (4) of Article 4 (Fiscal Residence), for any year of assessment beginning on or after 6 April 1976."

ARTICLE VI

(1) This Protocol shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) This Protocol shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged and shall thereupon have effect in accordance with Article 28 of the Convention.

In witness whereof the undersigned, duly authorized thereto by their respective Governments, have signed this Second Protocol.

Done in duplicate at London this day of 1977.

For the Government of the United Kingdom of Great Britain and Northern Ireland:	For the Government of the United States of America:

partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: J.C. Davenport
Extension: 2951
February 10, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES TENTATIVE DETERMINATIONS TO MODIFY OR REVOKE DUMPING FINDINGS WITH RESPECT TO POTASSIUM CHLORIDE FROM CANADA AND CLEAR SHEET GLASS FROM JAPAN

Acting Assistant Secretary of the Treasury John H. Harper announced today two tentative determinations under the Antidumping Act of 1921, as amended. In the first case, Mr. Harper announced a "Tentative Determination To Modify or Revoke Dumping Finding" with respect to potassium chloride (otherwise known as muriate of potash) from Canada produced and sold by the Duval Corporation of Canada and by Amax Potash, Ltd., both of Saskatchewan Province. In the other case, Mr. Harper announced the same determination in regard to clear sheet glass from Japan. Notice of these actions will appear in the Federal Register of February 11, 1977.

The "Finding of Dumping" in the cases of potassium chloride from Canada and clear sheet glass from Japan was published in the Federal Register of December 19, 1969 and May 18, 1971, respectively. The "Finding of Dumping" with respect to potassium chloride from Canada has previously been modified to exclude 10 other Canadian producers of that product form the effect of the finding.

Before a tentative modification or revocation of a dumping finding can be issued, Treasury requires that the finding have been in effect for at least two years, that there be established a two-year period of no sales at less than fair value subsequent to the finding, and that price assurances be submitted. After an allowance for oral and written presentations, Treasury will then consider whether to issue a final modification or revocation.

Imports of potassium chloride from Canada amounted to $20.6 million during January - June 1976 and imports of clear sheet glass from Japan were valued at $1.5 million during calendar year 1975.

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epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 11, 1977

SIDNEY L. JONES APPOINTED FELLOW AT THE WOODROW WILSON INTERNATIONAL CENTER FOR SCHOLARS

Sidney L. Jones, former Assistant Secretary of the Treasury for Economic Policy, has been appointed a Fellow of the Woodrow Wilson International Center for Scholars, at the Smithsonian Institution in Washington, D.C., according to an announcement by Dr. James H. Billington, Director of the Center. Dr. Jones resignation as Assistant Secretary was accepted by President Ford effective January 20, 1977.

Prior to his appointment as an Assistant Secretary at Treasury, Dr. Jones served in several government capacities--Senior Staff Economist and Special Assistant to Paul H. McCracken, Chairman of the Council of Economic Advisers; Minister-Counselor for Economic Affairs to NATO in Brussels; Assistant Secretary of Commerce for Economic Affairs and Deputy Assistant to the President and Counsellor to the Secretary of the Treasury.

Dr. Jones was awarded the Treasury Department's Exceptional Service Award by former Secretary William E. Simon. The Secretary noted:

> "As Assistant Secretary of the Treasury for Economic Policy, Sidney L. Jones has exemplified the highest professional and personal qualities in promoting sound and effective public policies to meet the needs of a rapidly changing public environment. He has demonstrated exceptional ability to crystallize complex economic issues and to articulate them clearly in writing and orally. In this regard, he has contributed greatly to the establishment of responsible and well-balanced fiscal and monetary policies."

Dr. Jones was born September 23, 1933. He was valedictorian of the 1954 graduating class at Utah State University and then served as an officer in the U.S. Army until 1956. He received his M.B.A. (1958) and Ph.D. (1960) degrees from Stanford University.

He is married to the former Marlene Stewart. They have five children and live in Potomac, Maryland.

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epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 10:00 A.M. February 11, 1977

TREASURY TO AUCTION $2,500 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $2,500 million of 2-year notes to refund $1,515 million of notes held by the public maturing February 28, 1977, and to raise $985 million new cash. Additional amounts of these notes may be issued at the average price of accepted tenders to Government accounts and to Federal Reserve Banks for their own account in exchange for $150 million maturing notes held by them, and to Federal Reserve Banks as agents of foreign and international monetary authorities for new cash only.

Details about the security are given in the attached highlights of the offering and in the official offering circular.

Attachment

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HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED FEBRUARY 28, 1977

February 11, 1977

Amount Offered:	
To the public..........................	$2,500 million
Description of Security:	
Term and type of security...........	2-year notes
Series and CUSIP designation........	Series M-1979 (CUSIP No. 912827 GM 8)
Maturity date........................	February 28, 1979
Call date............................	No provision
Interest coupon rate.................	To be determined based on the average of accepted bids
Investment yield.....................	To be determined at auction
Premium or discount..................	To be determined after auct-
Interest payment dates...............	August 31 and February 28
Minimum denomination available......	$5,000
Terms of Sale:	
Method of sale.......................	Yield auction
Accrued interest payable by investor.............................	None
Preferred allotment..................	Noncompetitive bid for $1,000,000 or less
Deposit requirement..................	5% of face amount
Deposit guarantee by designated institutions........................	Acceptable
Key Dates:	
Deadline for receipt of tenders.....	Thursday, February 17, 1977, by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds.......	Monday, February 28, 1977
b) check drawn on bank within FRB district where submitted..................	Thursday, February 24, 1977
c) check drawn on bank outside FRB district where submitted..................	Wednesday, February 23, 197
Delivery date for coupon securities.	Wednesday, March 2, 1977

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OUR RECORDS INDICATE THAT YOU OWN MATURING TREASURY SECURITIES TO BE REFUNDED BY THE TREASURY IN ITS CURRENT OFFERING.

THE ENCLOSED " HIGHLIGHTS" SHEET CONTAINS THE PERTINENT DETAILS OF THE OFFERING. IF YOU ARE INTERESTED IN PARTICIPATING, APPLICATION SHOULD BE MADE TO ANY FEDERAL RESERVE BANK OR BRANCH OR THE BUREAU OF THE PUBLIC DEBT, WASHINGTON, D. C. 20226. OR IF YOU PREFER, YOU MAY ENGAGE A COMMERCIAL BANK OR SECURITIES DEALER IN YOUR AREA TO FORWARD YOUR APPLICATION AND MATURING SECURITIES. COPIES OF THE OFFERING CIRCULARS ARE AVAILABLE AT ANY FEDERAL RESERVE BANK OR BRANCH.

PARTICIPANTS IN THE OFFERING SHOULD CONSULT THE HIGHLIGHTS FOR THE DEPOSIT REQUIREMENT FOR EACH PARTICUAR ISSUE OF SECURITIES. BOTH THE DEPOSIT AND FINAL PAYMENT MAY BE MADE IN CASH OR WITH MATURING TREASURY SECURITIES. IN CASE YOU HOLD ANY OF THE SECURITIES IN COUPON FORM, THEY SHOULD BE FORWARDED BY REGISTERED MAIL.

IF FINAL PAYMENT IS TO BE MADE BY CHECK, YOUR ATTENTION IS DIRECTED TO THAT SECTION OF THE HIGHLIGHTS UNDER "KEY DATES" WHICH SPECIFIES THE FINAL DATES FOR RECEIPT.

THE BUREAU OF THE PUBLIC DEBT

epartment of the TREASURY NEWS

ASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. February 11, 1977

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 million, or thereabouts, to be issued February 24, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,600 million, or thereabouts, representing an additional amount of bills dated November 26, 1976, and to mature May 26, 1977 (CUSIP No. 912793 G4 2), originally issued in the amount of $3,601 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,600 million, or thereabouts, to be dated February 24, 1977, and to mature August 25, 1977 (CUSIP No. 912793 J7 2).

The bills will be issued for cash and in exchange for Treasury bills maturing ebruary 24, 1977, outstanding in the amount of $6,204 million, of which overnment accounts and Federal Reserve Banks, for themselves and as agents of oreign and international monetary authorities, presently hold $2,762 million. hese accounts may exchange bills they hold for the bills now being offered at he average prices of accepted tenders.

The bills will be issued on a discount basis under competitive and non-ompetitive bidding, and at maturity their face amount will be payable without nterest. 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 ook-entry form to designated bidders.

Tenders will be received at Federal Reserve Banks and Branches and from ndividuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to :30 p.m., Eastern Standard time, Friday, February 18, 1977. ach tender must be for a minimum of $10,000. Tenders over $10,000 must be n multiples of $5,000. In the case of competitive tenders the price offered ust be expressed on the basis of 100, with not more than three decimals, e.g.,).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 or at the Bureau of the Public Debt on February 24, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing February 24, 1977. 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, or from the Bureau of the Public Debt.

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epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: Lisle Widman
566-5232

FOR RELEASE AT 4:00 P.M. FRIDAY, FEBRUARY 11, 1977

U.S.-PORTUGAL REACH AGREEMENT ON $300 MILLION CREDIT

The Treasury Department and the Bank of Portugal today formally approved the provisional agreement reached December 31, 1976, for the extension of up to $300 Million in short-term credit from the US Treasury Exchange Stabilization Fund to the Bank of Portugal. The ESF arrangement is envisaged as the first phase of a program of assistance -- involving this short-term credit, possible drawings from the IMF by Portugal, and a proposed medium term multilateral credit facility -- designed to achieve financial stability and recovery of the Portuguese Economy.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: Robert E. Nipp
566-5328

FOR IMMEDIATE RELEASE

February 14, 1977

TREASURY SECRETARY BLUMENTHAL
APPROVES LIMITED JONES ACT WAIVER FOR
WILLIAMS ENERGY COMPANY, INC., OF TULSA, OKLAHOMA

Secretary of the Treasury W. Michael Blumenthal today notified the Williams Energy Company, Inc., of Tulsa, Oklahoma, that he has granted a limited waiver of the Jones Act to permit transportation of liquefied propane gas (LPG) from Houston, Texas, to Norfolk (Chesapeake), Virginia, in two foreign vessels. No U.S.-flag LPG carriers technically capable of carrying this cargo are immediately available.

Williams Energy Company had requested a waiver of the coastwise laws, commonly called the Jones Act (46 U.S.C. 883), to permit the use of the FERNBROOK, a Norwegian-flag vessel, and the FERNWAVE, a Liberian-flag vessel, to each make one voyage delivering 6,000 metric tons or a total of 12,000 metric tons (148,800 barrels) of LPG. In approving the waiver, Secretary Blumenthal stated that the two voyages must be completed within 15 days of today's date.

The propane will be used to supply customers in Virginia, North Carolina, Maryland, and Pennsylvania, including defense installations and defense-related industries.

In his decision, Secretary Blumenthal said that on the basis of recommendations from the Departments of Defense and Commerce and from the Federal Energy Administration, he had determined that a waiver limited in time and scope was necessary in the interest of national defense.

The text of the Secretary's decision letter is attached.

# # #

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THE SECRETARY OF THE TREASURY
WASHINGTON

FEB 11 1977

Dear Mr. Dubin:

This responds to your letter of February 2, 1977, requesting a temporary waiver of the coastwise shipping prohibition in the Jones Act (46 U.S.C. 883) on behalf of Williams Energy Company, Inc., to permit the use of two foreign vessels for the transport of liquefied propane gas from Houston, Texas, to Norfolk (Chesapeake), Virginia.

The Department of Defense has advised me that there are adverse effects of the current gas shortage, and the potential resultant shortages of petroleum fuels, on production facilities engaged in the manufacture of items for the Department of Defense and on defense installations, and that continued shortages are expected to lead to further serious curtailments of production in many industries related to the Department of Defense industrial base, thus resulting in continued, if not increasing, adverse impact on Department of Defense programs and readiness.

The Federal Energy Administration has advised me that the lack of adequate supplies of gas results directly in a high level of industrial curtailments when unusually cold weather requires a heavy diversion of gas from industrial and large commercial users to residential users. FEA also noted that, because the need to fill severely depleted reserves will result in continued industrial load curtailments, additional supplies of propane would result in a reduction of such curtailments. FEA has, therefore, urged me to grant the requested temporary waiver in order that the United States may fully meet its defense requirements.

The Department of Commerce has advised me that no LPG carrier in the U.S. fleet is available for the transport of LPG from Houston, Texas, to Norfolk (Chesapeake), Virginia.

I have, therefore, determined that a waiver on the conditions outlined below is presently necessary in the interest of national defense. Pursuant to the authority contained in the Act of December 27, 1950 (64 Stat. 1120), the restrictions against engaging in the coastwise trade imposed on the FERNBROOK, a Norwegian-flag vessel, and the FERNWAVE, a Liberian-flag vessel, by Section 883 of Title 46 of the United States Code are waived for a period of 15 days from this date subject to the following conditions:

(1) Each vessel will be used only for transporting liquefied propane gas, in the amount of approximately 6,000 metric tons per voyage, from Houston, Texas, to Norfolk (Chesapeake), Virginia.

(2) Each vessel will engage in no more than one voyage for this purpose.

(3) Each vessel will be approved by the U.S. Coast Guard for entry into the ports involved and for offloading at the terminal facilities in the destination port.

Appropriate U.S. Customs Service officials have been notified of this waiver.

Sincerely,

W. Michael Blumenthal

W. Michael Blumenthal

Allan S. Dubin, Esq.
Hall, Estill, Hardwick, Gable,
Collingsworth & Nelson, P.C.
1701 Pennsylvania Ave., N.W.
Washington, D.C. 20006

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: Robert Standard
Extension: 2951
February 14, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES
REVOCATION OF COUNTERVAILING DUTY ORDER
ON SPIRITS FROM GREAT BRITAIN

The Treasury Department announced today that it will no longer collect countervailing duties on spirits of any kind from Great Britain. A countervailing duty order on spirits from the United Kingdom of Great Britain and Ireland has been in effect since May 25, 1914. The original order had been amended several times during the last 63 years as export bounties on particular kinds of spirits were eliminated. The Treasury Department has now verified that the British Government has eliminated all remaining subsidies on the export of spirits. Accordingly, the Department will publish in the Federal Register of February 15, 1977, a notice revoking the original countervailing duty order issued on May 14, 1914.

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Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

THE DEPARTMENT OF THE TREASURY 1789

FOR IMMEDIATE RELEASE February 14, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,502 million of 13-week Treasury bills and for $3,602 million of 26-week Treasury bills, both series to be issued on February 17, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 19, 1977			26-week bills maturing August 18, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.834	4.613%	4.73%	97.550	4.846%	5.04%
Low	98.827	4.640%	4.76%	97.538	4.870%	5.06%
Average	98.829	4.633%	4.75%	97.542	4.862%	5.05%

Tenders at the low price for the 13-week bills were allotted 94%.
Tenders at the low price for the 26-week bills were allotted 41%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 24,895,000	$ 16,895,000	$ 23,920,000	$ 6,920,000
New York	3,796,895,000	2,056,050,000	5,770,365,000	3,035,675,000
Philadelphia	20,495,000	18,495,000	15,445,000	5,445,000
Cleveland	36,320,000	33,570,000	234,165,000	47,365,000
Richmond	32,105,000	21,985,000	37,270,000	17,320,000
Atlanta	30,725,000	27,965,000	14,925,000	14,925,000
Chicago	283,335,000	109,885,000	470,275,000	257,375,000
St. Louis	42,220,000	33,205,000	27,330,000	16,330,000
Minneapolis	39,880,000	21,700,000	27,735,000	12,735,000
Kansas City	82,410,000	68,925,000	16,725,000	16,725,000
Dallas	35,695,000	22,695,000	14,815,000	9,815,000
San Francisco	195,455,000	70,315,000	390,200,000	161,550,000
Treasury	75,000	75,000	50,000	50,000
TOTALS	$4,620,505,000	$2,501,760,000 a/	$7,043,220,000	$3,602,230,000 b/

a/Includes $366,840,000 noncompetitive tenders from the public.
b/Includes $137,080,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE UPON DELIVERY

STATEMENT OF THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 16, 1977 at 2:00 p.m. EST

Mr. Chairman, I am here this afternoon to testify on the Administration's request for funding of U.S. participation in the Inter-American Development Bank. We are requesting appropriation of $1,060 million to permit the Bank to continue making its crucial contribution to the economic development of Latin America.

Of this amount, $460 million are requested in a supplement to the FY 77 budget. We ask for these funds in a supplemental request, rather than as part of the FY 78 budget, because they are urgently needed by the IDB before the FY 78 appropriations would be available. The remaining $600 million is part of the Administration's regular FY 78 budget request.

The IDB and Economic Development in Latin America

The Inter-American Development Bank was established in 1959, with nineteen Latin American nations and the United

States as charter members. Today the membership of the Bank includes twenty-five Western Hemisphere nations and twelve nonregional countries -- ten from Europe plus Japan and Israel. The Bank's subscribed capital stock currently totals $7,464 million, of which the U.S. share is 36 percent.

In its sixteen years of existence, the Bank has become the single most important source of financing for social and economic development in Latin America, not only from the point of view of project financing but also through technical assistance and development planning and programming.

Latin America is of major economic interest to the United States in terms of trade, direct investment and access to raw materials. Over the past five years, U.S. exports to Latin America averaged $13 billion annually and our imports from the region similarly averaged $13 billion. In 1976 U.S. exports to the region amounted to 15 percent of total U.S. exports worldwide. The latest data available on U.S. direct investment indicate that about $17 billion, or 14 percent of total U.S. direct investments abroad, is in Latin America. This represents about 60 percent of U.S. direct foreign investment in the developing countries, and results in investment income to the United States of more than $1 billion per year. Latin America is also a major source of essential commodities. For example, in 1975, we obtained 38 percent of our copper, 73 percent of our bauxite, 47 percent of our sugar, and 40 percent of our coffee from Latin America. Thus, the economic success of our Latin American neighbors is of considerable importance to us and to world prosperity in general.

Among the world's developing regions, Latin America has recorded the highest rate of economic growth over the past ten years. Countries as diverse as Brazil and the Dominican Republic have been among the fastest growing economies in the world. Their annual GNP growth was averaging ten percent before the sharp increases in oil prices and ensuring world recession. GNP in Latin America as a whole has been growing at almost seven percent per year in real terms. Since 1960, value added in manufacturing in the region and installed electrical capacity have tripled, while primary school enrollments have quadrupled. Adult literacy increased from about 52 percent in 1950 to about 73 percent in 1970, and the number of rural families with access to potable water has tripled. The IDB has been a major factor in these accomplishments.

In spite of this progress, however, half the population of Latin America has a daily caloric intake below minimum requirements. More than a third of the primary school-age population is without education facilities or unable to attend school. A quarter of all adults are illiterate. Forty percent of urban households lack potable water. Infant mortality in

Latin America is 80 per 1000 live births, as compared with 19 in the United States. Agricultural production is expanding only slightly faster than population growth. Despite an abundance of land and rural manpower the countryside is marked by poverty and unemployment.

In short, there remains much to be done. Self-help is crucial to development, but Latin America also requires an expanded flow of external finance to sustain the momentum of its economic and social development. The region still includes a sizeable group of poor countries -- such as Haiti, Honduras, Jamaica, Bolivia and Guyana -- that need concessional resources, and there are major sectors within individual countries -- Brazil, Mexico, and Colombia, for example -- where economic and social development are lagging far behind. The IDB must be able to play an even greater role in meeting the development challenge in Latin America.

IDB Resources

The Bank carries out its financing operations through two lending windows. Loans from the capital window are made at near market terms, while concessional loans are made from the Fund for Special Operations (FSO). The IDB also serves as administrator for eleven special funds provided by both member and nonmember countries. Of these funds, which total nearly $1.2 billion, the two largest are the $525 million Social Progress Trust Fund placed under the Bank's administration in

1961 by the United States and the $500 million Venezuelan Trust Fund established in 1975.

The Bank's capital lending is financed from the paid-in capital subscriptions of its members and from the proceeds of borrowings in the international capital markets. These borrowings are backed by the members' callable capital subscriptions and therefore represent a potential budgetary outlay for the member countries only in the unprecedented event that the Bank could not meet its obligation to bond-holders.

The IDB has established a sound reputation as a borrower in international financial markets where its bonds carry a triple-A rating. In its sixteen years of existence the Bank has borrowed more than $2.5 billion, of which over $1 billion was borrowed in the United States. At the end of 1976, the Bank's total outstanding debt amounted to $2.1 billion.

At the end of 1976, the IDB's capital stock totalled $7,464 million of which $1,126 million was paid-in capital and $6,338 million was callable capital. These capital resources represent the Bank's initial capitalization in 1959 and four successive replenishments, including the current one. It also includes subscriptions from the new nonregional members, whose entry into the Bank was part of our effort to mobilize additional resources for IDB operations over the 1976-78 period.

A new class of capital stock called inter-regional capital stock, was created with the entry of the nonregional countries to enable the IDB to borrow against the callable capital of the nonregional members and of Canada. Previously, the Bank's bonds contained a covenant limiting borrowing, backed by ordinary capital, to U.S. callable capital available on demand, i.e., appropriated callable capital. When all the outstanding bonds which contain the covenant are retired, the two classes of capital, interregional and ordinary, will be merged.

Capital loans from both the ordinary capital and the new interregional capital are made at an interest rate of 8.35 percent with maturities ranging from 15-30 years. To improve the IDB's financial strength and credit standing, the IDB recently adopted a new procedure for relating more closely the interest rate on capital loans to the Bank's cost of capital.

The Fund for Special Operations enables the Bank to provide concessional resources to its poorest member countries. FSO loans are made at a rate of interest of 1 to 4 percent and maturities of 20 to 40 years, depending on the relative economic strength of the borrowing country and the type of project financed. Although the financial yields on such projects may be low, they are necessary for social as well as economic development, (e.g., rural water supply or credit for small farms.) These projects benefit primarily low income areas or groups in much of rural Latin America or needy urban areas. FSO loans are extended entirely from resources provided by the members of the Bank. Since its creation, the FSO has grown, as a result of successive replenishments over the years, from $146 million in 1959 to $4,768 million at the end of 1976.

Bank Lending Activities

During its sixteen years of operations, the IDB has lent a total of $10.2 billion in support of Latin American economic and social development projects whose total value exceeds $41 billion. Of this, $4.7 billion was loaned from the Bank's capital resources and $4.7 billion from the FSO on concessional terms. The Bank's lending from 1961 through 1975 represents about 40 percent of the total development financing for Latin America from the international development banks and AID. In 1976, alone, the IDB accounted for 49 percent of official external capital for Latin America.

About a quarter of its loans, or $2.5 billion, have financed high-priority agricultural development projects. Electric power projects and transportation and communications, also important sectors for Bank financing, have received $2.0 billion and $1.8 billion, respectively.

In recent years the Bank has increased its efforts to assist the least advantaged segments of Latin American society.

IDB loans to its least developed members -- Haiti, Paraguay, Bolivia and the Central American countries except for Costa Rica -- have risen from $286 million in 1974 to $424 million in 1976. More indicative of the Bank's special support for these countries is the amount of concessional lending channelled toward their development. The percentage of IDB concessionary loans going to these countries has risen from 17 percent in 1970 to almost 50 percent in 1976. The Bank has led the way in financing potable water, rural electricity, and health and education projects which directly affect the daily lives of millions of needy people throughout Latin America.

Two recent loans illustrate clearly the socio-economic benefits of the Bank's efforts to reach lower income groups-- a loan to Guatemala for rural health services and a loan to Chile for potable water.

Guatemala has one of the lowest life expectancy rates in Latin America, and its organized health care services are few or nonexistent outside of major urban areas. The $28 million FSO loan to Guatemala approved in April 1976 will help build and equip health facilities in rural areas which were severely damaged by the earthquake which devastated much of Guatemala in February 1976. About 22 percent of Guatemala's population, or 1.3 million persons, will directly benefit from improved health services; these are people who live in the country's least developed regions and belong to its lowest income sector.

Two other FSO loans totaling $22 million were also extended as part of the reconstruction efforts launched in the wake of the earthquake. These loans, which provided credits for farmers and businessmen, along with the rural health loan, demonstrate the IDB's ability to use the regional experience of its staff to respond quickly and effectively to local needs.

Health conditions in the rural areas of Chile are deficient mainly because of communicable disease resulting from contaminated water supplies and inadequate sewerage disposal. A recently approved FSO loan to Chile for $7.5 million will help supply clean, safe drinking water to 870,000 persons in 150 small towns located in rural areas of Chile which totally lack residential drinking water. This project will, therefore, be a major factor in improving the health of Chile's rural poor.

The IDB has also been an innovator in lending for integrated rural development where organizational and logistical problems are especially complex. Such projects combine rural health services, education, small farmer credits and feeder roads. One of the most recent examples of the Bank's activities in this area is a $64 million FSO loan to Colombia approved in August 1976. The IDB is financing 59 percent of a $109 million integrated rural development program designed to increase real income and employment opportunities for rural families by providing such things as roads, electrification, water supply, health and education. A large portion of Colombia's rural population lacks economic and social infrastructure services, and the per capita income of the rural population is only half the national average. About 42,000 farm families will benefit directly from the program.

The IDB has also made an effort to assist poor farmers through agricultural credit programs. During 1975 and 1976 the Bank approved loans totaling $285 million to cooperatives and similar organizations. The majority of these funds were convertible currencies lent on concessional terms. Bank management estimates that more than two and a half million people will benefit from the work which will be undertaken by cooperatives enterprises.

In addition to its innovative activities in supporting integrated rural development projects and promoting lending through cooperatives, the Bank is in the forefront in encouraging Latin American integration projects. The Bank has promoted projects which benefit more than one member country, such as the Acaray hydroelectric project in Paraguay, which delivers part of its output to Argentina and Brazil; an integrated road project which serves several countries in Central America; and the Trans-Andean highway between Argentina and Chile.

The Bank is also concerned with maximizing the multiplier effect of its lending program. The Bank has actively supported technical assistance to countries to help them identify and develop new loan projects consistent with national develoment plans, strengthen institutions fostering Latin America's development, supply manpower training, and support activities which have a great impact on Latin America's future economic and social goals. In the last five years the Bank's technical assistance operations increased sharply from under $6 million per year to over $30 million per year.

The Bank has become increasingly interested in ensuring that the technologies used in its projects are appropriate to the development goals of the borrowing countries and to local socio-economic conditions. The Bank recognizes that, in many cases, intermediate or light capital technologies are appropriate to achieve a country's development goals, given the scarcity of capital and abundance of relatively unskilled labor. In November 1976, as a result of a U.S. initiative, the IDB Board of Directors approved a policy under which the Bank will make the development and use of intermediate or light capital technologies an increasingly important facet of its lending program. A standing committee for the application of appropriate technologies was also established in the IDB at that time to provide information and guidance to the Bank staff. While the Bank needs to do more in the area appropriate technologies, some of its programs -- such as fisheries development projects, agricultural assistance to the small farmer, and small industry loans -- have focused directly on the problem of developing and applying intermediate technologies as effectively as possible.

Recent Replenishment of IDB Resources

At the end of 1975, the Bank's ordinary capital was virtually exhausted and concessional resources were scarce. In June 1976, following Congressional authorization, the United States agreed to participate in a $6.3 billion replenishment of the Bank's resources for the 1976-79 period. At the same time, the United States and other IDB donor countries approved changes in the Bank's charter needed to permit donor countries from outside the Western Hemisphere to join the Bank.

Under the terms of the replenishment, the regional member countries agreed to provide the Bank with $5,303 million in authorized capital stock and $1,045 million in the Fund for Special Operations in annual installment over the 1976-79 period. Of this total, the United States is to provide $2,250 million, the Latin Americans $3,588 million, and Canada $307 million. The capital payments of all the members are linked, and unless the United States subscribes to an installment, contributions will not be forthcoming from the other members and the replenishment will not proceed.

This arrangement was included in the replenishment agreement to ensure that the U.S. vote did not fall below 34.5 percent, thereby causing us to lose our veto in the Fund for Special Operations.

In addition, as part of the overall resource mobilization, but not the replenishment itself, the nonregional countries are expected to contribute about $745 million over the 1976-78 period; half of this amount would go to subscribed capital and the other half to the FSO.

The U.S. share of the capital increase is $1,650 million. In order to enable the IDB to sustain its lending operations, the Administration had originally expected to subscribe this amount in three equal annual installments of $40 million paid-in and $360 million of callable capital in FY 1976, FY 1977, and FY 1978. However, we are now in danger of falling behind this schedule. An additional $450 million of callable capital is to be subscribed in FY 1979. The proposed U.S. contribution to the FSO is $600 million, which the Administration expects to provide in three annual install ments of $200 million over the FY 77-79 period.

The U.S. share of new resources for the IDB under this replenishment would be 37 percent, compared with the 52 percent U.S. share during the last replenishment initiated in 1970. Of the total amount of convertible currencies to be made available under the current replenishment, the U.S. contribution represents 80 percent of the FSO and 48 percent of the capital resources. The composition of U.S. participation would be 73 percent capital and 27 percent FSO, compared to 45 percent and 55 percent, respectively, in the 1970 replenishment exercise. The impact on budget outlay would be $720 million, compared with $1,150 million under the 1970 replenishment.

The primary reason the U.S. contribution will entail smaller budgetary outlays and account for a smaller share of the new IDB resources is that this replenishment, and the entry of the nonregional, members will result in wider burden-sharing. The wealthier Latin American countries have agreed to make a greatly increased portion of their FSO contributions convertible. Since they have also agreed not to borrow FSO convertible currencies during this replenishment, their convertible contributions will be used to finance development in the poorer Latin American countries.

Greater participation by other countries is financing economic development in Latin America has been a long-standing objective of U.S. policy. The recent replenishment package reflects the success of our efforts to achieve a greater sense of partnership of the Latin American and non-regional countries with the United States in support of financing development.

Appropriations Requests

As I indicated this morning, the IDB now faces severe resource shortages which contrain its lending operations. Here we are requesting $460 million in the FY 77 supplemental: $20 million in paid-in inter-regional capital for the first payment of the current capital replenishment; $240 million for the second installment to the current replenishment; and $200 million for the first installment of the FSO. (The $240 million for capital represents $200 million in ordinary capital and $40 million for paid-in inter-regional capital.)

Unless the United States makes available the $460 million requested in the FY 77 supplemental to the IDB soon, the Bank will be forced to curtail drastically or perhaps halt, lending operations until the FY 78 appropriation is approved. The United States subscribed to only $300 million of the $400 million payment which fell due for all Bank members at the end of 1976. The next payment will be due in late spring. If the United States fails to complete the first payment and delays making the second payment, no capital subscriptions will be forthcoming from the other regional members, for the reason I described earlier. The Bank will be able to continue making capital loan commitments only until the convertible currency resources on hand in the capital accounts are exhausted, which could occur as early as this spring.

The United States has not yet contributed any of the $200 million of its first installment of the current replenishment of the FSO. The IDB cannot use any of the FSO funds contributed by the other members under the current replenishment until the U.S. contribution is made available. We understand from the Bank that there are only enough convertible currencies available in the FSO to continue concessional loan operations through April. This is why we are requesting Congress to appropriate the $200 million as soon as possible in FY 77.

FY 1978 Appropriations Request

Of the $600 million appropriations requested for FY 78, $40 million is for paid-in inter-regional capital, $160 million is for inter-regional callable capital, $200 million for ordinary callable capital and $200 million for the Fund for Special Operations. The $400 million of capital would represent the third payment to capital under the replenishment, most of which is due by December 1977. The $200 million of FSO represents the second contribution, which will be due at the end of December 1977.

Conclusion

The United States must participate in the current replenishment in a timely manner to enable the IDB to avoid having to halt, or seriously limit its lending operations this spring. Such a result would be tragic since the IDB is making a vital contribution to the economic and social development of Latin America, and the needs of the Bank's poorest and middle income members have risen sharply in the wake of the world recession and higher oil prices. I believe it is in our best interest to help the Bank continue its work to foster healthy, amicable relations with our Latin American neighbors. Therefore, I urge prompt action on our appropriations requests -- particularly for the supplemental appropriations needed for FY 1977.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE UPON DELIVERY
FEBRUARY 16, 1977

STATEMENT OF THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 16, 1977 AT 2:00 p.m. EST

Mr. Chairman, I would like to turn now to our appropriations request for the African Development Fund. Congress authorized U.S. membership in the African Development Fund in May 1976 with a contribution of $25 million. It appropriated $5 million of this amount in the FY 1976 Foreign Assistance Appropriations Act and $10 million in the FY 1977 Act. The United States joined the Fund on November 18, 1976 with a $15 million contribution. We are seeking in FY 1978 the remaining $10 million authorized by the Congress last May. The contribution of this $10 million will raise the U.S. voting power in the Fund to 3 percent. Completion of the $25 million initial U.S. contribution to the Fund will give substance to the United States' determination to play a progressive role in African development.

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The African Development Fund is the concessional loan affiliate of the African Development Bank. The Bank was founded on September 24, 1964, with the governments of twenty two independent African states as members, to promote investment of public and private capital in Africa. It had initial capital resources of $300 million and a staff of 45. During its twelve years of operations the capital stock of the Bank has increased to $960 million, its membership to 46 nations and its staff to almost 300 persons.

Membership in the Bank continues to be exclusively African. The Bank is located in Abidjan, Ivory Coast and is currently headed by Dr. Kwame Fordwor, a distinguished Ghanian economist and expert in international finance and banking, who received his Ph.D in economics from the University of Pennsylvania. Immediately prior to his election as president of the African Development Bank in May, 1976, Dr. Fordwor was Finance Minister of Ghana. From 1966 to 1971 he served as a senior official of the International Finance Corporation.

Recognizing that its resources are limited and that it needs to improve the technical skills of its staff, the Bank has made a considerable effort to increase its effectiveness, and that of the Fund, through cooperation with international organizations and bilateral agencies.

Many of the Bank's professionals have attended the Economic Development Institute of the World Bank which trains officials in the techniques of project development and appraisal. The United Nations Development Program, the World Health Organization and the Food and Agriculture Organization have worked closely with the Bank staff in preparation of programs in health and agriculture. The Bank has also received externally provided funding and personnel for technical assistance from the same groups.

Of the Bank's authorized capital resources, half is paid-in and half is in the form of callable capital. Of the paid-in portion, about $210 million is in convertible currencies. The Bank's largest members in terms of subscriptions of capital stock are Nigeria, Algeria, Libya and Gabon. They are all members of OPEC and account for almost one-third of the Bank's resources. Some member countries have contributed additional loanable resources to the Bank. Nigeria, for example, has established a $80 million Trust Fund and Algeria has turned over its $20 million of the Arab Oil Fund for Africa to be administered by the Bank.

Through December 31, 1976, the Bank had made loan commitments totaling $407.8 million for 135 projects in 37 member countries. Bank lending is concentrated in the public utilities and transport sectors, but the Bank also makes loans to development institutions which relend to medium and small businessmen and farmers. In 1976, the Bank committed $91 million for 28 projects. Since 1972, all its loans have been made at 6 percent per annum plus a 1 percent commission fee. Maturities normally range from 8 to 20 years, plus a grace period of from 3 to 6-1/2 years.

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 the thirty-three United Nations' "most seriously affected" (MSA) countries are African. About 75 percent of the African population is engaged in subsistence agriculture. In half of the countries, per capita income is less than $100 per year. Because of these serious problems, many of Africa's developing nations simply cannot afford to borrow at the interest rate and maturities offered by the Bank. To meet the need for softer terms for these countries, the Bank decided to establish a source of concessional funds.

In 1966, in recognition of these problems, and in an effort to increase the involvement of the industrial nations in African development, the Bank undertook discussions with developed countries to establish 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. Following the Fund's establishment, donor nations and the African Development Bank pledged about $147 million in concessional loan resources to the Fund.

The Fund is legally separate from the Bank and managed by its own twelve man board of directors. Six of the directors, having 50 percent of the vote, are chosen by the Bank, and six are elected by the donor countries. A 75 percent weighted vote is required for all operational decisions. The present members of the Fund are the Bank, representing all of its member countries, the United States, Canada, Brazil, Japan, Saudi Arabia, and twelve European donors.

The Fund has no independent staff, but uses the staff of the Bank. All credits are made on IDA terms; a 3/4 of one percent service charge, with a forty-year maturity plus a ten-year grace period.

A resolution for the first replenishment of the resources of the Fund to cover the years 1976 to 1978 became effective on June 15, 1976. As a result, pledged resources to the Fund increased to $395 million. The U.S. contribution of $15 million in November, 1976 raised the level of resources pledged to the Fund to $410 million. As of September 30, 1976, $177 million of the replenishment total of $248 million had been contributed. The non-regional members of the Fund with the largest contributions, together with their percent of voting power currently are Canada (11.2%), Japan (7.5%), Germany (6.3%), Sweden (4.5%), Norway (3.75%), and the Netherlands (3.0%).

The Fund has laid out an ambitious lending program for the next three years. Management has estimated that during 1977-79, the Fund will lend between $350 and $385 million. The Fund's pipeline of potential loans currently contains 72 projects, mainly in the agriculture and transport sectors, totaling $373 million.

During the first two years of operation (1974 and 1975), the Fund made 40 loans totaling $140 million 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.

In 1976, the Fund made 18 loans totaling $80 million. Thirty-three percent of Fund credits in 1976 were allocated to the agriculture sector. Public utilities received 27 percent, transportation 19 percent, health 14 percent, and education 7 percent of resources last year.

A representative example of an African Development Fund project is a $5.5 million loan to finance the foreign exchange costs of a water supply project in Malawi. The government of Malawi sees the development of a safe water supply as a major prerequisite to the overall development of the country. The goal of the project is to improve, expand, and in some cases provide new water supply to 42 Malawi district centers. The project is expected to meet demand up to 1986. Many of these centers are important economic areas where other development projects have been delayed because of the lack of potable water. The project will also provide direct economic benefits to the country in the form of increased forestry output and tourist development.

Another example of the African Development Fund's effort is a $4.4 million irrigation project in Mauritania. The purpose of the project is to increase and diversify crop production by replacing flood-irrigated crops with canal-irrigated corps. The goals of the project are to be achieved by: (1) construction of 13.7 kilometers of dikes, (2) development of an irrigation and drainage network, (3) construction of a pumping station, (4) development of cultivated land, (5) construction of silos and buildings, (6) the setting up of a pilot farm, and (7) engineering and technical assistance. When fully operative the project will help supply 25 percent of Mauritania's rice and 15-20 percent of its wheat and maize. Moreover, the project will produce considerable fodder and allow expansion of cattle production in the region. In all 18,000 people should benefit from this project.

In the education sector, African Development Fund loans include a $5.0 million loan to Chad to construct and equip the National Institute of Education Science and the Teacher's Training Center. The purpose of this project is to set up a new system of education oriented toward vocational training. The National Institute of Education Science is to become the institution responsible for the conception, experimentation, and support of government policies on educational and scientific training. The Teacher's Training Center will admit two hundred trainee teachers, forty education counselors, and twenty primary school inspectors between 1980 and 1982 to carry out the policies of the Institute. The project will make Chad less dependent on foreign technical assistance and save foreign exchange by reducing the need to send students abroad.

When the United States joined the Fund on November 18, 1976 it formed a voting constituency with the United Kingdom and Yugoslavia. The United Kingdom presently provides the Executive Director, and Yugoslavia the Alternate Director. The British will retain the directorship and Yugoslavia the Alternate Directorship until the election of Directors at the African Development Bank/Fund meeting in Mauritius in May. The United States hopes to provide the director or alternate director commencing in May 1977. In the meantime, the United States has assigned a professional staff member to Abidjan to coordinate U.S. participation in the affairs of the Fund.

Mr. Chairman, in closing I want to discuss in broad terms the implications of United States membership in the Fund and the importance of this appropriations request. The cost of U.S. membership in the African Development Fund is comparatively small and the U.S. percentage share is modest. Yet there are significant potential benefits for us: a strengthened economic presence in an area of growing importance to the United States, demonstration of our concern for the development and prosperity of this region and the opportunity to benefit from the export market created by the Fund's activities. U.S. - African trade totals many hundreds of millions of dollars annually. In the midst of the current energy crisis, it is appropriate to note that the United States depends on African suppliers of crude petroleum for more than one-third of its oil imports.

U.S. participation in the Fund is also consistent with our foreign policy towards Africa. Africa's proximity to the Middle East, as well as the situation in southern Africa, makes it important for the United States to have influence there as we strive for world peace in new ways. American participation in the African Development Fund is an important element of this strategy.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE UPON DELIVERY

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE FOR
INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON FOREIGN OPERATIONS OF THE HOUSE
APPROPRIATIONS COMMITTEE
WEDNESDAY, FEBRUARY 16, 1977, AT 3:00 P.M., EST

Mr. Chairman and Members of the Committee:

I am happy to testify today on behalf of the Administration's request for an appropriation of $30 million to be contributed in Israeli pounds for the U.S. contribution to the endowment of the Israel-U.S. Binational Industrial Research and Development Foundation. The United States share will be derived from simultaneous prepayment by Israel of a portion of its PL-480 local currency debt to us. Thus, the actual U.S. payment will be in Israeli pounds. Public Law 480 permits the use of foreign currencies accruing from sales under PL-480 to support programs and projects of scientific cooperation between the United States and other countries. An appropriation is necessary for the United States to participate, however, because Israel is no longer an excess currency country.

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The Agreement establishing the Binational Industrial Research and Development Foundation was signed by the United States and Israel on March 3, 1976 as an outgrowth of the work of the Israel-U.S. Joint Committee for Investment and Trade. This Committee was established in July 1974 to foster closer economic ties between the two countries and to stimulate cooperative endeavors, outside our existing security and military assistance programs, that would provide benefits to both countries through maximization of trade and investment flows.

At its 1975 meeting, the Joint Committee explored the question of industrial research and development cooperation between Israel and the United States and agreed on the desirability of developing a program to support mutually beneficial industrial research and development activities. As a result, representatives of the Commerce Department's Office of Science and Technology and the State Department's Science and Economic Bureaus joined the Treasury in developing with their Israeli counterparts, the framework of a Foundation to provide impetus to collaborative efforts to synergize more fully the research and development capabilities of the two countries.

The Foundation's objective is to promote mutually beneficial research and development activities which would provide direct economic gains to both the United States and Israel, through the development of and participation in new external markets, increased exchange of materials between the two countries, and increased expenditure for goods and services in both countries.

This objective is reflected throughout the financial provisions of the Foundation's Agreement. We have set stringent mutual benefit criteria for project selection. Roughly half of the Foundation's income is expected to be spent in the U.S. Investment of some of its income not currently used for spending will also be made in the U.S. In addition, the Foundation will share in the proprietary rights, and will receive royalties, that might accrue from any inventions resulting from the research and development activities it will fund.

As I indicated earlier, the U.S. contribution of $30 million will be derived from Israel's prepayment of all outstanding PL-480 debt without maintenance of value provisions, which at present amounts to approximately $17 million, supplemented by the prepayment of approximately $13 million of PL-480 debt with maintenance of value provisions, from the latest maturities. That part of the endowment derived from debt without maintenance of value will be denominated in Israeli pounds and will yield 4% interest, and will be protected from the effects of Israel's high inflation by a linkage to changes in the cost of living index in Israel. The part derived from the debt with maintenance of value will be denominated in dollars and bear interest at the rate of 5 1/2% per year. In the event of dissolution of the Foundation, the U.S. contribution, as well as half of any additional assets of the Foundation, will revert back to the United States.

Our acceptance of Israel's prepayment of some of its outstanding debt is based on the knowledge that the real cost of this arrangement is considerably less than one would suspect. This is due to the fact that a dollar's worth of local currency in the future is worth less to us than that same currency is worth today, because a substantial portion of those receipts will be adversely affected by high inflation rates and consequently will buy fewer goods and services for the United States in the future. In nominal terms, the value of the local currency debt that Israel will prepay is $30 million; however, taking into account the cost of money and inflationary trends, we estimate that the value of the local currency debt would be closer to $10 million.

In conclusion, we believe that the Foundation has the potential to provide tangible advantages to the U.S. economy at a relatively modest start-up cost. In addition, the activities of the Foundation will be consonant with broader United States objectives for the Middle East, since it will permit Israel to strengthen its economy, especially its export sector, thereby lessening its dependence on United States assistance in the long term.

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FOR RELEASE UPON DELIVERY

STATEMENT OF THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 17, 1977 at 10:00 a.m. EST

Mr. Chairman, and members of the Committee, I am here today to seek your support for the Administration's FY 1978 appropriation request of $523 million for the International Bank for Reconstruction and Development (IBRD), also known as the World Bank. This request, if approved, would enable the United States to make the first of three equal installments toward our share of the proposed Selective Capital Increase for the World Bank. Appropriations for the remaining two installments will be sought in FY 79 and FY 1980.

The proposed $8.3 million Selective Capital Increase will alleviate a serious resource constraint currently facing the Bank. It will enable it to continue lending to developing countries at about current commitment levels while the Administration institutes the intensive, comprehensive review of all bank activities which I discussed with you yesterday. Before discussing the specifics of the proposal before you, I would like to review briefly the important responsibility that the Bank carries in today's rapidly changing and increasingly interdependent world economy.

The Role of the Bank

The Bank is an extraordinarily successful financial institution which has made available more than $27 billion, mostly originating from private funds, to its clients since its founding in December 1945. The Bank is the patriarch of the family of development institutions -- it is the oldest and largest (with 128 members), and it probably exercises more influence than any other single institution upon the policy directions that developing countries pursue. The Bank helped rebuild Europe after World War II, and it graduated Japan from borrower status in the mid-1960s. Now it faces its greatest challenge: encouraging and directing sound and productive development in the emerging nations.

The challenge the Bank faces today is enormous in both complexity and magnitude. Unlike IDA, which addresses the most basic human needs faced by the people of countries at the very bottom of the developmental ladder, the Bank's clientele is essentially middle income developing countries which have a high absorptive capacity, well-conceived development programs and adequate managerial talent. Before 1973, many of these countries appeared to be entering a period of self-sustaining rapid growth. But the shock of the energy crisis, subsequent inflation and recession set back appreciably their growth outlooks. Domestic consumption and export growth rates fell sharply. Current account deficits rose, leading to sharply increased borrowing at hard commercial terms. These countries weathered the crisis, but at a high cost in terms of growth momentum and foregone future growth and increased debt service charges.

The future for many of the middle income countries is now uncertain. Most have had sufficient the resource endowments and political will to make at least partial adjustments and they may, under certain conditions, return to the rapid growth rates of the early 1970s. But while the fundamental development outlook for these countries remains promising in general, success will require different and much more difficult policy action in a world which is undergoing basic structural change as a result of the events of 1973-75. It is in formulating, financing and implementing these policy changes that these countries must obtain continued and expanded Bank assistance.

The adjustment process these countries are facing will involve many actors. But the Bank has an important role to play. This role does not include providing debt financing or alleviating short term balance of payments problems. There are other mechanisms -- such as commercial banks and International Monetary Fund facilities -- available to deal with these problems, though any cessation of flows from the Bank would, of course, increase the burden on those institutions.

But the World Bank's chief role is to help make the structural changes that will encourage long term economic growth. This means promoting sound capital investments, which lead to export growth and, in the long term, to lower current account deficits. It means promoting the sort of fiscal responsibility and discipline that will ensure the efficient use of available domestic resources. And it means developing the country economic reports and comprehensive economic models that will guide borrowing countries seeking maximize their comparative advantage.

These changes usually cannot be achieved in two or three years. Often they require many years of patience, perseverance and political effort. Thus, the Bank's long repayment schedules are necessary to prevent short term financial crises and unmanageable debt burdens from seriously impeding the long-term development effort.

The Bank's ability to meet this challenge requires a dual personality -- that of a development bank whose clients need resources and expert advice. and that of a financial institution which is largely dependent upon the support of its bondholders. I would like first to discuss briefly its developmental side.

Lending Activities

To help deal with the recent economic crises, the Bank has accelerated its lending activities. Compared to a $2.0 billion lending level in FY 1972, the World Bank, in the fiscal year ending June 30, 1976, committed a record $5 billion to developing countries with an average maturity of 20 years and an interest rate of almost 8-1/2 percent. The Bank has increased its lending activities from an average of 74 projects and $2.0 billion in commitments a year between FY 1971-73, to an average of 123 projects and $4.2 billion in commitments a year in the last three fiscal years.

The Bank's lending program represents a variety of functional and regional operations. In FY 1976, the Bank made 33 percent of its commitments to Asia and the Pacific, 28 percent to Latin America and the Caribbean, 22 percent to developing countries in Europe, the Middle East and North Africa, and 10 percent to sub-Saharan Africa. Operations in agriculture and transportation represented the largest areas of Bank activity in FY 1976, accounting for $1,209 million (24%), and $1,115 million (22%), respectively. Lending in other sectors, with their respective percentages in FY 1976, included $697 million (14%) to development finance companies, $690 million (14%) for electric power, $501 million (10%) for industry,

$246 million (5%) for water supply and sewage, $245 million (5%) for education, $80 million (2%) for urbanization, $75 million (2%) for non-project aid, and the remaining two percent for telecommunications, planning, and tourism.

The World Bank has in the last five years made substantial shifts in its patterns of lending. This is particularly the case in the area of rural development. Total lending to agriculture, in constant dollars on an annual basis, has been more than twice as high in the last three years, FY 1974-76, as in the previous five years. Within this expanding overall agricultural program, there has also been a substantial increase in the proportion of assistance designed expressly for improving the productivity and incomes of the rural poor. Whereas only 27 percent of agricultural operations -- 10 per year -- were rural development projects in FY 1969-73, some 55 percent of the agricultural program in the last three years has focused on the rural poor, including 38 operations approved in FY 1976.

The Bank is now the largest single external source of funds for direct investment in agriculture in developing countries. In the five year period, FY 1974-78, the World Bank plans to finance projects which have as their objective increasing incomes in rural areas by as much as 300 percent in several developing countries.

The change in the pattern of Bank lending away from traditional infrastructure projects includes a shift in the sectoral pattern, a widening and deepening of the purposes of lending, and the emergence of "new style" projects. The Bank's lending for agriculture has widened over this period to include financing of storage, marketing, processing, farm credit, fisheries and forest projects, in addition to the more traditional irrigation and infrastructure projects. The number of projects providing benefits to small scale agricultural and the rural poor has increased. For example, a recent Bank project in Egypt will develop fruit and vegetable production for home use and marketing. By improving vegetable seed and seed potato inputs, and creating packing and marketing facilities, this project will create between 10,000 and 15,000 jobs. The majority of the funding will come from the Egyptian government.

Although there is no urban analogue to the small subsistence farmer and his family, the Bank is also pursuing a strategy to help the poor become productive citizens in urban areas. Planned lending targets involve both direct lending for identifiable urbanization projects and the reorientation of lending previously programmed for industry, development finance companies, and water supply and sewerage projects. Close to 50 new urbanization projects are planned for the five year period, FY 76-80. These will include site and services projects, squatter settlement upgrading programs, small-scale enterprise financing, as well as projects to bring to the poor such basic services as transportation, electricity and basic education.

During the first year of this plan, the Bank made loans to deal with two of the worst urban slums in the developing world: those in Lima, Peru and Kuala Lumpur, Malaysia. As many as 200,000 slum residents in Lima and Arequipa will benefit from provision of water, sewers and electricity, the construction of access roads, and health and nutrition centers. The $21.6 million Bank loan -- one-half the total project cost -- will help provide industrial "sites and services" to both communities, while in Lima, core housing and commercial "sites and services" will be provided. With the help of a $32 million Bank loan the Malaysian Government will be able to make more efficient use of existing and planned transport facilities in the Kuala Lumpur area. In addition, 2,100 squatter households, some of which were displaced by highway development, will be provided with infrastructure services near their old homes, and other households and businesses will be provided with residential and business "sites and services." As part of this $72 million project, technical assistance will be provided for the preparation of a national "sites and services" program, emphasizing integrated development of small-scale industries and low-cost housing.

The Bank's Resources

The Bank's role as a financial institution is critical because of its extraordinary ability to mobilize resources in the world's capital markets. Rather than depending upon public funds from governments for its operations, the Bank obtains most of its operating cash by borrowing in international capital markets.

During the 1970s, the Bank derived 68% of its resources from the sale of securities to investors through the world's financial markets. In FY 1976, forty-one issues, totaling $3,811 million, were sold by the Bank; an increase of $301 million over FY 1975. Gross borrowing by the Bank in the five fiscal years 1972-76 totaled $12.6 billion, more than 2.6 times the volume of such borrowings in the previous five year period. These securities enjoy a triple "A" credit rating due to the excellent financial record of the Bank and the guarantee provided by members' callable capital. The United States market has been the principal source of borrowings (25% of the total). The Bank has also tapped markets in Germany (21%) and Japan (10%), and, particularly during FY 1974-75, in the OPEC countries. As a result it was able for a time to reduce its dependence on the United States market. As of June 30, 1976, total IBRD borrowings outstanding amounted to $14.6 billion.

The second largest source of Bank funds is loan repayments, on which, incidentally, the bank has never had a default. In the last six years, loan repayments have provided 20 percent of its lending resources. In this same period, retained earnings accounted for 7 percent of Bank lending resources. Thus far, the Bank has built up $1.9 billion in reserves, principally from interest and commitment fees.

Net income in FY 1976 -- $213 million -- was down somewhat from the previous year due to increased borrowing costs and lower yields on the Bank's liquid investments. The Bank has responded by adopting a new semi-automatic lending rate formula which will assure that its lending rate covers the costs associated with making the loans. This new formula is based on an index of borrowing costs, plus a spread to cover administrative and liquidity costs. Finally, loan sales and capital subscriptions provide the remaining lending funds -- about 5 percent from 1970 to 1976.

Because of the Bank's key financial role, and the risk of a default that any lender faces, I would like to elaborate briefly on how this risk is minimized in the Bank.

Because the World Bank is a market-based financial intermediary as well as a development institution, it needs to give assurance to both shareholders and purchasers of its bonds that its lending operations meet sound financial and operational criteria. This means that loans are made only to countries which are judged creditworthy. Secondly, Bank lending is predominantly directed towards specific projects, all of which have to meet high financial, technical, and economic standards. In addition, the identification and preparation of projects is conducted against the background of a thorough economic analysis of a country's economic prospects to ensure that investment decisions reflect intelligent priorities. In the appraisal process after a project has been identified, the Bank measures the economic benefits of a project and calculates the rate of return on the investment, wherever possible. Recently, the economic return from projects financed by IBRD has been averaging close to 20 percent per annum.

Once a loan has been approved, the Bank continues to supervise the implementation of the project until it is completed. A final stage in the Bank's quality-control process is carried out by a separate Operations Evaluation Department (OED) which was set up in 1970 to evaluate project results. The unit prepares reports to the Bank's member countries (through the Executive Directors) and to management on the actual results of operations in terms of contributions to development. About 15 percent of the Bank's staff time and administrative budget is devoted to this supervision and evaluation effort.

The Bank's Capital Structure

Under the original capitalization of the International Bank for Reconstruction and Development, the authorized stock of the Bank was valued at $10 billion of the weight and fineness of the U.S. dollar in effect on July 1, 1944. A total of $7,670 million of the authorized capital was subscribed by June 30, 1946, and the U.S. subscription was $3.175 million, or 41 percent. In 1959, the authorized capital of the Bank was increased by $11 billion. Of this increase, $10 billion was provided to permit a doubling of all existing subscriptions, including that of the United States, and $1 billion was provided for subscriptions by new members and special increases in subscriptions by existing members. Subsequent increases in 1963, 1965 and 1971 have brought the Bank's authorized capital to $27.0 billion in 1944 dollars, or $32.4 billion in current dollars. (At present, about $1.6 billion of the authorized capital is unsubscribed.) The United States subscription has been increased over time to $6,473 million in 1944 dollars, or $7,808 million in current dollars, representing a gradual reduction of our relative share to 25 percent of total Bank capital. Although other nations have often made additional subscriptions which included a paid in portion, the United States has had to pay in additional funds only with regard to the 1971 increase. At that time, $123.05 million was appropriated by the Congress.

Member subscriptions are essentially divided into paid-in capital, representing ten percent of the total, and callable capital, representing ninety percent of the total. The paid-in portion consists of one percent in gold or U.S. dollars; and nine percent in the currency of the member country. As of June 30, 1976, the gold portion which the Bank can use freely in its operations totaled $308.2 million. The member currency portion totaled $2.77 billion. Some of these funds -- $121.5 million -- were converted by members into dollars and were freely usable by the Bank. The remainder was not converted and could be used by the Bank in its lending operations only with the consent of the members. As of June 30, 1976, $1.97 billion had been used with such consent.

The callable capital portion enables the Bank to tap capital markets for the bulk of its lending resources. This portion of subscribed capital is not available for lending. It is subject to call if required to meet obligations on Bank borrowings. This callable portion of member countries' subscriptions, amounting to $27.8 billion in current dollars, guarantees the servicing by the Bank of its obligations and distributes the risk in accordance with the economic strength of each member. The Bank, however, has never had a default on any of its loans, and it has never had to call on this guarantee authority. In the remote chance of loan defaults by its borrowers, the Bank would first have recourse to its ample reserves (now about $1.9 billion) before making calls on callable capital.

The Selective Capital Increase

In order to continue to play a major role in the development process and promote sound economic policies among its borrowing members, the Bank needs additional capital. Without a capital replenishment, the Bank will be unable to sustain its annual loan commitments at their present level or expand lending activity into new areas of investment to benefit the poorest borrowers. Under its Articles of Agreement, the volume of loans which may be disbursed and outstanding must not exceed its total unimpaired subscribed capital and reserves. Based on projected disbursements, the Bank will reach this statutory limit in FY 1982. The proposed increase of $8.3 billion would allow the Bank to sustain its present level of commitments without reaching the limitation in the Articles and without any further capital increases.

The proposed increase in capital subscriptions by Bank members parallels recent special increases in the IMF quotas. This policy of parallelism is based on the view that members whose relative economic strength has increased as reflected by a larger quota in the IMF. can be expected to take a corresponding increase in their subscriptions to the capital of the World Bank. This policy also has the effect of maintaining members' relative voting strength in the two institutions at approximately the same level. The United States strongly supports this policy of parallel special increases as a means of ensuring that the burden of support for the Bank falls on countries in proportion to their ability to bear it.

The capital increase will take place in two stages, since the new subscriptions cannot be accepted by the Bank until the resolution providing for the increases in the authorized capital stock has been approved by the Bank's Board of Governors. In the first phase, 70,000 new shares will be created, each having a par value of $100,000 in 1944 dollars. This will increase the authorized capital of the Bank from slightly over $32.3 billion to $40.8 billion in current U.S. dollars. In the second phase, after the increase in authorized capital becomes effective, each member country will be able to subscribe up to its allocated number of shares. When these shares have been subscribed and current pending subscription increases for members have been processed, the Bank will have total subscribed capital of $39.4 billion, leaving $1.4 billion in unallocated shares available for new members or members desiring an increased share.

The United States and other Countries

The U.S. share of the proposed increase would be $1,569 million. This represents 19 percent of the total capital replenishment, as compared to the 25 percent of the International Bank for Reconstruction and Development's subscribed capital that the United States currently holds. As a consequence, the total U.S. share of World Bank capital would drop to 24 percent. The United States subscription would increase by 21 percent, from $7.8 billion to $9.4 billion.

Most of the other developed countries will increase their subscriptions by significantly larger percentages. In aggregate terms, the subscriptions of the other developed countries will increase by $2.6 billion, or approximately 31 percent of the total increase. The largest subscriptions in this category will be made by Germany, Japan, France, the Netherlands, Belgium, and Canada. Among OPEC and the developing countries, the largest subscriptions will be made by Saudi Arabia, Iran, Nigeria, Venezuela, Kuwait, Indonesia and Brazil.

With the slight reduction in the United States participation in World Bank burden sharing, the United States voting strength in the Bank will drop from 22.60 percent to 21.86 percent. This reduction will allow the capital surplus countries to play a larger role in financing the Bank, while not significantly affecting our voting strength.

However, failure of the United States to take part in the special increase would mean that the our voting strength would fall to 18.91 percent. Since it takes 80 percent of total voting power to amend the Bank's Articles of Agreement or expand its Board of Directors, the United States would lose its veto power with regard to such changes if it did not participate in the capital increase. Appropriations for the United States subscription will be sought in three equal annual installments of $523 million from FY 78 to FY 80. The 10 percent paid in portion would result in budgetary outlays of $52.3 million each year over the same three year period.

Conclusion

Because the United States is the largest single shareholder in the Bank, its approval of this capital increase is essential in psychological terms and extremely important in voting terms. Our 22.6 percent of total voting power is almost sufficient to prevent the capital increase from taking effect since it requires 75 percent approval of total voting power to become effective.

This increase is important to the Bank, its developing members, and to the United States. The Administration feels strongly that we must continue to maintain our influence on the operations of the world's largest international development lending institution. Failure to participate fully in this increase would result in a greatly diminished United States presence at a time when the developing countries are depending more than ever on us and the Bank to help them through the economic upheavals of recent times. On behalf of the Administration, Mr. Chairman, I strongly urge the full support of the Congress in this critical matter.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE UPON DELIVERY

STATEMENT OF THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 16, 1977 at 10:00 a.m. EST

Mr. Chairman, I would now like to testify in support of our requests totaling $289 million for the Asian Development Bank and its concessional loan window - the Asian Development Fund. In the FY 1977 supplemental bill we are seeking $25 million to complete our contribution to the Fund's original 1973-75 resource mobilization. For FY 1978, we are requesting $60 million as the first of three equal U.S. payments to a 1976-78 replenishment of Fund resources. In addition, we are seeking $203 6 million in FY 1978 for the ordinary capital resources of the Bank. This amount consists of $20.4 million in paid-in capital and $183.2 million in callable capital. It represents the first of four annual U.S. subscriptions to a general increase in the Bank's capital stock.

The Asian Development Bank was created in 1966 to foster economic growth and cooperation in the poorer countries of Asia and the Pacific. The Bank, which is headquartered in Manila, has 28 regional members, which provide 63% of its capital, and 14 nonregional members -- including the United States, Canada, and 12 West European countries which

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provide 37% of its capital. The aggregate voting power of the developed member countries, which includes all the non-re members plus Japan, Australia, and New Zealand, represents 58% of the total. The United States participated actively in the establishment of the Bank, and its subscription to the capital currently amounts to $603.2 million or 16.4% of the total. The U.S. contribution of $125 million to the Fund equ 13.5 percent of its total ADF resources as of December 31,197

Bank Lending Activities

After 10 years of operations, the Asian Development Bank has become an important factor in the economic development of Asia and the Pacific. The Bank has become a major source of capital and, as a regional organization, plays an important role in mobilizing self-help resources and bringing local knowledge to bear on Asian development problem

As of December 31, 1976, total loan funds committed by the Bank amounted to $3,360 million for 264 individual projects. Of these projects, 171 totaling $2,465 million are being financed from ordinary capital resources at near-market rates of interest and maturities of from 10 to 25 year The remaining $895 million represents 117 concessional loans financed from Asian Development Fund resources. These loans carry an interest rate of 1 percent and have maturities of 40 years. In calendar year 1976, the Board of Directors approved Ordinary Capital and concessional loans totaling $776 million.

In terms of geography, the Bank has made loans to twenty-three of its developing member countries from Afghanistan to Western Samoa. Much of this activity has taken place in countries which are important to the political and economic foreign policy interests of the United States. For example, by the end of 1976, $548 million of Ordinary Capital resources had been lent to Korea, $449 million to the Philippines $305 million to Thailand, and $291 million to Malaysia. Major borrowers from the Asian Development Fund include Bangladesh ($179 million), Pakistan ($133 million), and Nepal ($100 million). These and other countries whose economic and social progress is significant to stability in Asia have benefitted from the Bank's resources at small cost to the United States.

Of the $729 million in U.S. resources already contributed to the Asian Development Bank, only $319 million will result in budgetary outlays. The remaining $410 million is in callable capital - a highly contingent liability unlikely ever to be used. These U.S. contributions have a multiplier effect for financing development projects in Asia, by attracting private capital and inducing burden sharing contributions from other developed countries.

At the end of December 1976, the total estimated cost of projects for which the Bank has approved direct financing reached $6,159 million, of which Bank loans accounted for 45 percent. In addition, the Bank had provided indirect financing through intermediate credit institutions for projects with an estimated total cost of about $1,751 million, of which the Bank's portion amounted to 22 percent. The difference between the Bank's cumulative lending level, and the total cost of Bank-related projects is primarily attributable to the self-help efforts of individual recipient countries who are mobilizing their own domestic resources for Bank-assisted development projects. The ADB also joins with other multilateral, bilateral, and private sector sources to co-finance development projects.

The ADB has been paying close attention to the social impact of its operations in recent years. Of particular concern to the Bank are efforts to create employment opportunities and reach lower income groups. During the past few years, lending for agriculture and agro-industry has increased significantly. In 1976, lending to this sector accounted for 26% of total loans.

A good example of a loan from the Fund, approved in 1976, is the Afghanistan Seeds Project. This $14 million loan will assist in the establishment of seed production farms, seed processing plants, storage facilities, and other services for the production and distribution of certified seeds to farmers. The project will increase wheat production by 323,000 tons and seed cotton production by 32,500 tons. Annual farm incomes of about 200,000 end-use farmers are expected to increase by $17 to $80 per hectare. For about 1,500 contract seed growers, net revenue per hectare is expected to rise by $84 to $212. In addition, this project will enable the Government to derive optimum benefit from its sizeable investments in irrigation development and fertilizer distribution.

A Bank loan to the Thailand Southern Land Settlements project will finance $16 million of the estimated $39 million cost of a project to develop 16,000 hectares of rubber trees. It will also help finance construction and improvement of about 330 km. of rural roads, and settlement of 3,000 families in 45 new villages. Fourteen new village centers consisting of schools, clinics, and other facilities will be provided. The principal beneficiaries will be about 8,800 farm families (approximately 45,000 people) from the poorest segment of Thai society. The 3,000 settler families -- primarily Muslim farm laborers, tenant farmers, and rubber tappers -- will acquire new houses, better social services, and the opportunity to become land owners.

The Bank is also concerned with assisting Asian nations develop indigenous energy sources. A recently approved $12 million Coal Development loan to Korea will increase coal production of the Dai Han mines by over 35%. The cumulative net foreign exchange benefits of the project over its economic life are estimated to be approximately $450 million. As coal production from the project will be largely allocated to urban households in the form of briquettes to meet basic needs for residential heating and cooking, the project will have considerable impact on the urban poor in terms of reducing the cost of fuel.

The application of appropriate technology is another area of expanding Bank concern. An example is the technical assistance grant provided by the Bank in May, 1976 to the International Crops Research Institute for the Semi-Arid Tropics (ICRISAT). This assistance is for a comprehensive survey to identify and assemble the presently known and applicable agricultural implements used in the semi-arid tropics. It will also support research into the development of improved animal-drawn farm equipment and implements. Copies of the ADB's comprehensive, and I believe thoughtful, review of the entire appropriate technology issue have been forwarded to the Congress.

Bank Financial Resources

Ordinary Capital - The Bank's ordinary capital lending is primarily financed from (1) the paid-in capital subscriptions of members, and (2) proceeds of borrowings in international capital markets. Members' callable capital subscriptions are used exclusively to guarantee these borrowings and thus represent a potential budgetary outlay only in the unlikely event that the Bank could not meet its obligations to bondholders.

As of December 31, 1976, the Bank's subscribed capital stock amounted to $3,688 million, consisting of 29% paid-in capital and 71% callable capital. This stock is the sum of the Bank s original capitalization, the first general capital increase agreed to in 1971, and special capital increases subscribed by various member governments in 1973-76. The U.S. subscription of $603.2 million is the largest (with the Japanese) and amounts to 16.4 percent of the total.

Over the past seven years, the Bank has firmly established itself as a reputable borrower in the world's capital markets. Its bonds enjoy the highest, triple A rating. The Bank's reputation is based on the market's assessment of its management capability, its overall loan portfolio, and the guarantee provided by the callable capital subscriptions of its members. Gross Bank borrowings amounted to $284 million in 1975 and $460 million in 1976. The Bank's funded debt as of December 1976 totaled $1,084 million, of which $275 million, or 25 percent, was raised in the United States. The corresponding figures for Japan, Western Europe, and the Middle East are 24 percent, 33 percent, and 7 percent respectively.

At the 1976 annual meeting, the Board of Directors reported on the necessity for an increase in the Bank's capital stock. The Directors had examined the economic and financial needs of developing member countries and believed an increase in Bank lending from $625 million in 1977 to $925 million in 1981 was required. This amounts to a real increase of less than 5 percent per year. Financing this lending program implied a 135 percent increase in Bank capital stock, or a replenishment figure of about $5 billion.

On October 29, 1976, the Board of Governors adopted a resolution to increase the authorized capital stock of the Bank by slightly more than $5 billion. Under the agreed arrangements, 10 percent of the increase is to be in paid-in shares to be purchased in four equal annual installments in 19 1979, 1980, and 1981. The remaining 90 percent is in the form of callable capital.

Under the terms of the resolution, the United States would provide $814.3 million or 16.3 percent of the total. Ninety percent, or $732.9 million, would be callable capital and 10 percent, or $81.4 million, would be paid-in capital. Appropriation of $203.6 million ($183.2 million callable and $20.4 million paid-in) is being sought for FY 1978. Of the U.S. paid-in portion, 40 percent would be in cash and 60 percent in non-interest bearing letters of credit to be drawn down as needed to meet disbursement needs of the Bank. The callable capital portion does not increase Treasury outlays. It does, however, give financial analysts and the bond market greater confidence in the Bank's bond issues.

Thus, with no real cost to the United States government, the ADB will be able to borrow at better rates and longer terms than otherwise.

Appropriation of the requested funds will permit U.S. participation in the capital increase and ensure continued and significant U.S. influence in the Bank. As a key founding member of the Asian Development Bank and one of its two largest original shareholders, the United States has had a leading part in bringing the Bank to its present position of effectiveness and high reputation. The U.S. subscription will be leveraged with subscriptions from other members and borrowings from world capital markets to finance Bank lending for high priority development projects in East Asian countries, many of which are of strategic importance to the United States. The $20.4 million requested for paid-in capital, which will represent actual budgetary outlays, is less than the $24.1 million appropriated by the Congress for paid-in capital for the Bank in each of FYs 1975, 1976, and 1977.

Asian Development Fund

When the Bank was established it was recognized that it should provide financing on concessional terms to meet the needs of its poorest developing member countries. Prior to 1973 the Bank's soft-loan special funds were contributed on an unscheduled basis through bilateral arrangements between donor countries and the Bank. In 1973, the Bank'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 of $525 million for the Fund for the three-year period ending December 31, 1975.

In FY 1972 and FY 1975 the Congress authorized U.S. contributions to the special funds in the amount of $150 million, of which $125 million has been appropriated by the Congress. The final U.S. contribution of $25 million to the initial mobilization is included in the FY 1977 supplement appropriation request. Most other donors completed their contributions to the resource mobilization two years ago and have already made their first contribution to the current replenishment of the Fund. The Fund has nearly exhausted its presently available resources. This last $25 million, although a relatively small amount, will permit continued lending to the poorest Asian nations this year.

The original resource mobilization of the Fund was designed to finance concessional lending through the end of 1975. At the Bank's 1975 annual meeting, the Board of Directors presented a report urging attention to the pressing need for a resource replenishment to permit concessional lending to continue after 1975. Fund borrowers -- the Bank's least developed members -- were now faced with increased economic difficulties and worsening balance of payments situations growing out of the 1973 oil price increase and the ensuing world recession. While any member country with a 1972 per capita income of less than $300 is theoretically eligible for ADF loans, only countries with per capita income below $200 actually borrow from the Fund.

Following the 1975 annual meeting, multilateral negotiations were held to replenish the Asian Development Fund. Most donor countries were prepared to agree to contributions during 1976-78 equal to about 150 percent of their initial contributions. Because the United States had not yet completed its contribution to the original Fund resource mobilization, and consultations had not yet been held with the Congress, U.S. representatives did not concur in any overall replenishment level or specific U.S. share.

Understanding that the United States was unable to commit itself on the specific amount or timing of any contribution, the ADB Board of Governors, on December 3, 1975, adopted a resolution authorizing the Bank to accept contributions totaling $830 million from its developed member countries in amounts specified in the resolution, subject to possible later adjustment by the Board of Governors.

The United States abstained from voting and reserved its position on the proposed $231 million U.S. contribution, an amount based on the 150 percent increase formula.

Following consultations with Congress in mid-1976, the United States took advantage of a provision in the resolution permitting modifications in country shares, and requested a downward adjustment in its proposed contribution to $180 million. This change, together with several other adjustments, resulted in a new overall replenishment target of $809 million. The U.S. share of this total is 22.2 percent, which is less than the 28.5 percent U.S. share of the original resource mobilization. The largest share of the replenishment -- 33.7 percent -- is being financed by Japan.

Early Congressional action on both the authorizing legislation for our $180 million contribution and on the Administration's request for the appropriation of the first installme of $60 million is necessary to assure the success of the ADF replenishment. Under the terms of the replenishment resolutic the three annual installments of donors' contributions become available to the ADF only when certain trigger levels of contributions are attained. This assures that there is in fact ε equitable burden sharing among Fund donors. The first trigger level of $475 million in contributions was reached in June 1976. However, the second and third triggers cannot be attained in the absence of U.S. action. ADF lending may cease in mid-1977 pending receipt of the U.S. first installment of $60 million.

Hence the United States is in a pivotal position with regard to the future of the Asian Development Fund. The $25 million requested in the FY 1977 supplemental bill would permit the Fund to continue lending in early 1977. Payment of our first installment of $60 million to the replenishment in FY 1978 would then permit resumption of a normal rate of Fund operations and will assure nearly $200 million in further burdensharing funds to aid the poorest Asian nations.

Conclusion

In conclusion, I strongly recommend appropriation of the requested amounts. The Asian Development Bank is a key instrument in U.S. economic policy in Asia. The Bank was basically founded as a joint initiative of the United States and Japan, to provide development assistance to South and East Asian nations. It is an effective, visible, and noncontroversial instrument for fostering those kinds of national economic policies, regional cooperative efforts, and international economic relations conducive to democratic political and economic systems. It attracts European and Middle Eastern funds to promote operations supportive of U.S. economic and political interests. During a period of intense dialogue with the Third World over economic issues, the Asian Development Bank remains a successful, functioning, and relatively inexpensive investment in Asian development for the United States.

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BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 17, 1977 at 10:00 a.m. EST

Mr. Chairman and members of the Committee, I would like now to turn to our FY 1978 appropriation request of $44.6 billion to strengthen and expand the operations of the International Finance Corporation (IFC) - the only multilateral institution specifically designed to stimulate private sector expansion in the developing countries. The request represents the first of three annual installments of the total U.S. contribution of $111.5 million to the proposed $480 million increase for the Corporation. Since this is the first capital increase for the IFC since its establishment in 1956, I would like to review the role and operations of the IFC.

THE PRIVATE SECTOR IN DEVELOPMENT

The Administration regards the expansion of the IFC as a major element in our program for aiding the developing

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countries. The United States has always stressed that the development process involves a cooperative effort between the public and private sectors -- domestic and foreign. High levels of private investment have been a common factor behind the successful growth experience of several developing countries such, as Brazil and Taiwan. On the other hand, low rates of private investment have tended to be associated with low rates of economic growth. Public investments in infrastructure yield low returns if not followed up with further investment in more directly productive activities. The private sector has proven its effectiveness both in seeking out those investment opportunities that are most profitable, and in using available resources efficiently.

Despite this strong U.S. commitment to private enterprise, we have not provided sufficient support for private sector development. IFC has never had a capital increase and continues to operate essentially with its original $100 million base. As a consequence, its contribution to development is declining relative to investment from other sources. It is time to reestablish the balance in support for the private sector that was contemplated when IFC was founded.

THE ROLE OF THE IFC

The International Finance Corporation is a member of the World Bank Group. Its membership is similar to that of the World Bank and only Bank members can join the

Corporation. It shares the same Board of Directors as the Bank and the International Development Association. The Corporation is unique among international development institutions in that it operates without a government guarantee on its loans, and purchases equity participations.

The Corporation functions essentially like a private investment bank. It tries to increase the flow of private capital into productive investments by bringing together investment opportunities, domestic and foreign private capital, and experienced management. Its principal role is to provide and stimulate financing for projects which will increase the production of goods in the developing world. However, IFC enters the picture only when other funds are not available. The Corporation makes investments where sufficient private capital cannot be obtained on reasonable terms and the investment will make a useful contribution to the economic development of the country.

The Corporation invests in productive private enterprises through loans and stock ownership, or a mixture of the two. Its typical investment is a share subscription combined with a long-term loan. When sufficient equity is available, the Corporation will make a straight loan at near commercial terms, around ten percent with 7-12 years repayment. Where it invests in capital stock, it remains a minority partner without management control. The form of investment, the investment mix and terms depend on the circumstances, risk and prospective return in each case.

The Corporation does not finance government enterprises or enterprises run by governments. However, the Corporation will participate in enterprises in which there is government ownership, provided that there is independent management and the enterprises are operated in accordance with normal business principles. Such participation is particularly important to its least developed member countries where private investment capital is scarce.

The Corporation also functions as a neutral intermediary between private enterprise and government. The presence of the Corporation in an investment has been, in many cases, a determining factor in the decision of foreign investors to participate in projects in developing countries. It has also become increasingly engaged in technical assistance in the area of private development investment banks and capital markets.

IFC Operations

The International Finance Corporation came into existence on July 20, 1956, when 31 countries had taken up membership with a capital contribution of $78 million; it did not make its first commitment until June 1957. As of June 30, 1976, IFC membership had expanded to 105 countries with a total subscribed capital of $108 million. Annual commitments have increased from $2 million in 1957 to $245 million in 1976.

After an initial break-in period, in the late 1950s and early 1960s, IFC grew at a modest pace because it could not roll over its capital fast enough to expand rapidly. Its growth began to increase in 1965 when the Charter of the IFC and the IBRD were amended permitting the Bank to make loans to the IFC within certain specified limits. With the aid of these credits, and a management initiative to accelerate activity initiated in 1968, Corporation commitments rose rapidly. By June 30, 1976, total IFC commitments had grown to more that $1.5 billion. This total breaks down into five basic categories. Investments held by the Corporation for its own account were $779 million. The total amount mobilized through completed and pending sales and participations was $479 million. The Corporation has already received $142 million in loan repayments and had cancelled about $98 million in commitments. Only about $6 million of its total commitments, less than 0.4%, had to be written off - a very low percentage for a Corporation engaged in innovative activities in developing countries.

IFC's importance as a financial institution is magnified by its ability to join with significant financing from other sources. Since its inception, the Corporation has been associated with about $7.8 billion of investments and has assisted in financing some 271 enterprises in 61 developing countries. Most of these enterprises have been medium sized firms, controlled by local groups and with local management.

Three FY 1976 projects in countries where IFC had never previously invested are illustrative of this co-financing effect. A $465,000 loan and $70,000 contingent loan commitment contributed to a $1.6 million project to establish a tea processing plant and improve commercial services for the local tea industry in Rwanda. Other loan financing came from the Overseas Private Investment Corporation (OPIC) and from the Rwanda Development Bank. Equity capital was provided by the private U.S. sponsor and local investor.

In a Malawi project, IFC joined British and local interests to finance a $12.4 million expansion of an integrated textile mill to increase the output of cloth from locally-grown cotton for the domestic market. In Egypt, IFC joined domestic, Kuwaiti, and Saudi Arabian investors in supporting a $19.2 million ceramic project to produce sanitary ware and wall tiles, primarily for the domestic market but also for export. The Corporation provided a $4.3 million loan, $770,000 in equity capital and a contingent commitment of up to $635,000.

Geographic and Functional Distribution

IFC's projects have concentrated in countries where there is a vigorous private sector and/or extensive foreign private investment interests, e.g., Brazil, Mexico, Korea, the Philippines, Greece, Israel and Kenya. As of June 30, 1976, 39% of IFC's total commitments had been in Latin America and the Caribbean, 25% in Asia, 22% in Europe, 10% in Africa, and 4% in the Middle East.

IFC's activities have tended to emphasize industrial enterprises because manufacturing is largely in the private sector in the developing world, whereas infrastructure activities, for example, are usually carried out by the public sector. As of June 30, 1976, 76% of IFC's total commitments were in industrial enterprises, 10% in development finance companies, and 9% in mining projects. Total commitments have been made in the following types of businesses: 18% in iron and steel; 12% each in textiles and fibers, and construction materials; 10% in development finance companies; 8% each in pulp and paper products, and mining; 6% each in chemicals, and general manufacturing; 4% each in motor vehicles, and fertilizers; with the remaining 12% in various other areas.

IFC's Financial Resources

The financial resources for IFC's activities came from two separate sources. For its loan operations resources, IFC relies primarily on borrowings from the World Bank. However, the IFC is limited in the amounts of its borrowings by the IFC Charter 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, 1976, IFC's net worth was $187 million, placing the limit upon IFC borrowings at $748 million. As of the same date, IFC had already borrowed $498 million and would probably reach the ceiling early in FY 1980.

IFC's equity investments are derived from, and may not exceed, its unrestricted resources, mainly capital and accumulated reserves. As of June 30, 1976, these resources totaled $192 million, with existing investments of about $134 million. The existing ceiling on equity investments is expected to be reached in FY 1979.

Thus, in the absence of a capital increase, the Corporation would soon be limited in its future activities to resources returning to it in the form of loan repayments, and participation and equity sales. In FY 1976, these resources totaled only $120 million -- less than half the current commitment level. Furthermore, the existing level of participation from private financial institutions would decrease because IFC could afford to put in less of its own funds.

The Need for a Major Capital Increase

As I mentioned initially, the Administration feels that increased attention needs to be directed toward the role of the private sector in the development process. IFC is the principal international institution devoted to this objective. Yet IFC will soon be facing a serious resource constraint which could have a crucial impact upon how its operations are carried out in the future. IFC is at a crossroads.

Without the increased support of its shareholders through a major capital increase, IFC will be forced to become a more conservative institution. The approaching equity ceiling, when reached, would force IFC to make very few equity investments - lessening its ability to utilize its most unique and distinguishing characteristic. IFC would become essentially an intermediary using IBRD funds to make loans to the private sector. Its raison d'etre as a separate and distinct institution could be questioned, under these circumstances. Even on the lending side, IFC would be severely constrained by the ceiling in its Charter and could not grow as the needs of its private sector clientele have already grown, and will continue to grow.

The alternative if IFC is to continue its unique role, and expand its operations substantially, is a major capital increase which can meet its needs for six or eight years. A major capital increase will allow IFC to accelerate its activities among poorer members in Africa and South Asia, not only with credit but with a higher level of equity investments. It will also be able to increase its services -- promotional ventures, assistance to small-scale industries, technical assistance, and larger equity exposure to make up for a lack of domestic risk capital.

A major capital increase will allow IFC to increase its participation in large projects, particularly in the minerals sector. These projects of $500-700 million are activities which interest foreign investors. IFC can play a key role as a neutral intermediary between the host country and private investors, assuring a degree of fairer treatment for both. The large size of these projects insures they can have a strong positive impact on a country's development. IFC's effectiveness as a catalyst depends on having a significant stake in a project. Yet, its equity base limits the maximum size of its commitments for its own account in individual projects. As a matter of policy, IFC has kept its exposure in any single company to 10% of its capital and reserves, which presently amounts to a ceiling of about $19 million. If the Corporation is to combine prudent diversification with a significant role in the projects, it needs a substantial endowment of capital.

Because inflation and project size in developing countries have increased the cost of projects, IFC can no longer effectively participate in bigger projects. With the increased capitalization, IFC will be able to incur commitments in the $60-$70 million range for its own account in single projects and thus assume a more significant role in helping to mobilize resources for such large ventures.

The Replenishment

Under the proposed replenishment authorized capital stock would be increased from 110,000 shares (valued at $110 million) to 650,000 shares (valued at $650 million). Of the 540,000 additional shares, 480,000 would be allocated to increase subscriptions by existing members, and the remaining 60,000 would be reserved either for subscriptions by new members or additional sales of shares to existing members after the initial replenishment subscriptions are completed.

The United States has been asked to subscribe to an additional 111,493 shares, approximately 23%, of the proposed increase in paid-in-capital from all members. This compares with the roughly 33% of issued capital that the U.S. currently holds. When the replenishment is completed, the U.S. share should be reduced to about 25%. Commensurately, U.S. voting power will drop from about 26.5% to 24%.

The share of subscriptions of other developed countries and OPEC members will rise from 45% to 51%. Among the countries which are expected to increase their relative shares in IFC are Germany, Canada, Japan, Iran, Saudi Arabia and Venezuela.

THE FORM OF SUBSCRIPTION

The replenishment arrangements require that governments exercising three-fourths of the voting power vote in favor of the capital increase before the Corporation is empowered to increase its capital stock and accept subscriptions. Members representing over 50% of total IFC voting power have already approved the increase. A favorable U.S. vote is, therefore, required to bring the replenishment into effect.

The resolution establishes a procedure for subscription which as a general rule requires a member country to obligate itself to pay for its shares in its instrument of subscription in accordance with a specified schedule. In cases where this commitment must be qualified for legislative reasons, the member must pledge unconditionally to pay for 40% of its subscription, while undertaking to seek appropriate legislative action as soon as practicable for the remaining 60% to remove the conditional character of the commitment.

As a result of this arrangement, we are seeking in FY 1978 appropriations for 40% of the U.S. subscription, or $44.6 million. We plan to seek the remaining 60% in two equal parts in FY 1979 and FY 1980. The budgetary outlays resulting from this proposal would be spread out over 5 years beginning in FY 1978.

CONCLUSION

U.S. support for the IFC is a sensible way to pursue our policy objectives in the LDC's. The IFC is the only international agency designed to encourage private sector growth in the developing countries. It taps the private sector for the bulk of the investment capital in its projects, while applying the public spirit to the utilization of that capital. It can generate investment funds from local sources, foreign companies, and to a limited degree, from public sources. It creates a sizeable multiplier effect as IFC itself often provides only 5-10 percent of the capital for a given project. Because of its own involvement through equity investments, IFC inspires confidence in a minority position in local firms with local ownership.

In conclusion, Mr. Chairman, I believe it is in the national interest, and in the interest of the developing nations of the world, that we move ahead with this capital expansion. Because of the widespread support and momentum behind this proposal, the U.S. should reaffirm its leadership and support for the IFC increase through prompt Congressional approval of this appropriation request.

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OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 17, 1977 AT 2:00 P.M. EST

Mr. Chairman, and members of the committee, I turn now to our proposals regarding the International Development Association (IDA).

The Carter Administration is placing before you three separate appropriation requests for IDA:

-- $55 million in an FY 1977 supplemental request to complete the first U.S. installment for the fourth replenishment of IDA ("IDA-IV");

-- $375 million in the FY 78 budget for the third installment of the fourth replenishment of IDA;

-- $800 million in the FY 78 budget for the first installment of the proposed Fifth Replenishment of IDA ("IDA-V").

THE WORLD's POOR AND IDA

Before discussing the specifics of these three requests, I would like to summarize why the Administration places the highest priority on IDA and its activities.

In our view, the most important objective of foreign aid is to meet the minimum human needs of the people in the developing countries. This is precisely what IDA is trying to do. Its clients are the poorest nations of the world:

-- About 90 percent of IDA lending goes to countries with annual per capita income levels below $200. None of IDA's recipient countries have a per capita income above $375.

-- Most of these countries are in South Asia, and in Africa South of the Sahara, the poorest regions in the world.

-- IDA's lending policy stresses the financing of development projects that reach the lowest 40 percent of the income earners in borrowing countries.

The living conditions of the poorest people of these nations, earning under $100 annually per capita, are tragic. Compared to the industrialized countries, these poverty-stricken countries have:

-- An infant mortality rate eight times higher;

-- A life expectancy one-third lower;

-- An adult literacy rate 60% less;

-- A nutritional level, for one out of every two in the population, below minimum acceptable standards; and, for millions of infants, less protein intake than is sufficient to permit full development of the human brain.

The need for IDA to address these human problems has increased in recent years. The lowest income nations have been the most seriously affected by recent international economic events. The oil price increases, the subsequent inflationary surge, and the recent recession have hit these countries hardest. The industrial nations and the middle income LDCs generally have been able to recover with varying success from these crises but the poorest countries lack the resources, particularly the capital, with which to rebound. Their terms of trade have deteriorated in recent years. Many have simply been unable to attract sufficient capital from external sources to sustain their growth. The poorest countries have not been able to obtain sufficient loans from abroad to maintain their import volumes. As a result, the countries with per capita incomes below $200 have had little or no growth in per capita income since 1970; in the previous decade, they had grown at 2 percent per capita per year.

IDA's task is clearly of a long-term nature. Its borrowing countries must be helped both with money and technical assistance to diversify agriculture, improve literacy levels, dampen population growth, and adopt economic policy measures aimed at stable growth. But immediate conditions have sharply deepened the difficulties of IDA borrowers, and call for sharp increases in its lending capacity.

THE ROLE OF IDA

IDA is the largest single source of help to the poorest LDCs. Since its inception, IDA has lent over $10 billion to 66 countries. The largest recipients have been India, Pakistan, Bangladesh, Indonesia, Ethiopia, Egypt, and Tanzania. Why choose IDA to make these transfers?

There are several reasons. First IDA maintains the same high lending standards as its parent institution, the IBRD, IDA lends to countries which offer opportunities for productive development investment, but which because of either their poverty or their debt service burden are not eligible for IBRD loans. With almost the same memberships and the same professional staff, IDA and the IBRD are essentially identical institutions, with similar objectives and procedures. The principal difference between the two institutions is the source of funds. IBRD lending resources come primarily from the world's capital markets. IDA's resources come primarily from donations by the world's developed nations -- the approximately twenty-one traditional donors who will be joined in the IDA V by new OPEC donors.

Let me elaborate briefly to illustrate the extent of IDA's professionalism. Every week the Executive Directors of IDA, in which voting power is weighted according to financial contributions by member countries, review and approve IDA credits proposed by the institution's 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; and institutional reforms essential to project success are made a condition of credit disbursement.

Once a project is approved, IDA closely oversees its execution. Careful supervision is exercised at the procurement stage to assure compliance with fair international competitive bidding and award of contracts to the lowest bidder. Disbursements are made only when satisfactory documents evidencing conformity with the credit and project agreements have been reviewed by IDA staff. Reports on project implementation are regularly received, and frequent on-site inspections by IDA officials are made.

Effective internal auditing and evaluation functions are also well established in the IDA. The IBRD/IDA evaluation department, established a few years ago at U.S. urging, evaluates all projects within one year after loan funds have been fully disbursed with a view to strengthening future operations. The evaluation unit reports directly to the Board of Directors.

A second reason for IDA's high standing among development institutions is that its effect upon the development process is much greater than the level of its loan commitments. As important as is its transfer of resources, IDA's role in insisting on sound economic policies and priorities, and institution building, is of equal importance. The lower income countries need far-reaching changes in their development policies to bring about the structural changes needed for more rapid growth, and for direct attacks on such problems as food production and rural income. By directing its funds carefully, IDA influences and supports the development effort necessary -- though sometimes politically difficult -- to carry through on these changes. Its work toward the achievement of more equitable income distribution exemplifies this role. Wherever possible, its lending activities are concentrated on projects which, in addition to contributing to economic development, also, to the maximum extent possible, raise incomes and expand employment opportunities for the poor.

IDA gives considerable emphasis to agriculture and rural development since most of the poorest people live in the rural areas. Since its inception, IDA's has lent more funds (29%) for agriculture than any other sector. IDA lending for agriculture has increased from 14% of the total in the FY 1964-68 period to 31% in the FY 1973-76 period. One of the FY 76 loans, a $5 million irrigation and drainage project in Chad, is expected to raise the yearly incomes of 1,200 families there from $35 to about $145. Under this project, irrigation and drainage networks will be built on land reclaimed from Lake Chad, and a package of services -- relocation assistance, training, extension, credit and marketing -- will be provided to farmers.

In addition to agriculture, IDA helps the poorest sectors in the countries it assists -- a course of action consistent with concerns expressed in the Congress. Education projects assist the rural and urban poor to achieve literacy and attain employable skills. An FY 1976 loan of $11.6 million to

Malawi, for example, will finance construction of twenty-two primary schools, a like number of rural education centers, and a teacher training college. The project aims at assisting the Government's education strategy which gives priority to the growth of primary education, improvement of rural secondary schools, and strengthening of nonformal education.

In the field of electric power, IDA also seeks out the most needy. A $57 million loan to India for rural electrification will help benefit about 55,000 small farmers; power will be made available for irrigation pumping, small industries, and for residential and street lighting in over 6,000 villages.

A third reason for the United States to support IDA is its ability to generate additional development funds. A U.S. contribution of $5 million generates at least $10 million of other donor funds for IDA. IDA resources are also frequently matched by funds from other developmental institutions and host governments. For example, an FY 1976 loan of $15.6 million to Niger will be accompanied by funds from the local government, the Arab Bank for Economic Development, and the African Development Bank to finance a $28.7 million highway development project aimed at supporting agricultural development. Similarly, a $4.1 million loan to Gambia, coupled with funds from the Arab Bank, the Gambian government, and the United Kingdom, will finance an $11.7 million project to double the per capita incomes of about 48,000 poor farmers living in 65 villages in the western part of the country. The project will increase cereal and cash crop production through "package" programs, and boost cattle production through better husbandry practices and marketing.

Fourth, IDA attempts to foster policies that will hasten the time when recipient countries will be able to finance their development from other external sources and from their domestic savings. Since September 1973, when IDA IV was negotiated, eight former IDA recipients (Tunisia, Thailand, Botswana, Philippines, Indonesia, Guyana, Morocco and Bolivia) no longer require IDA credits. It will be the policy of this Administration to maintain, and hopefully accelerate, this "graduation" process so that IDA capital can be channeled increasingly to the very poorest countries.

IDA lending is thus concentrated in South Asia and Africa, because the bulk of the world's poor live in those regions. About 61 percent of the population of all countries with per capita incomes of less than $200 is to be found in South Asia. Countries in that region also account for over 60 percent of the urban poor with per capita incomes less than $100, and 60 percent of the rural poor with per capita incomes less than $50.

I would like to note at this point that a ceiling of 40% of total IDA credits has been maintained on IDA lending to India. Although this ceiling results in India receiving a lower per capita aid level than most other IDA recipients, it enables a reasonable geographic balance to be achieved in the overall distribution of IDA credits. As a result, many African countries receive a higher per capita aid level than does India. Total IDA lending to sub-Saharan Africa has increased from 24.6 percent to the total in FY 1972-74 to 27.3 percent in FY 1975-76. In recognition of the enormous development needs of Africa, the IBRD/IDA has given increasing attention in recent years to the region, as indicated in part by the establishment of small but effective resident missions in Nairobi and Abidjan to help identify and prepare good development projects.

Because IDA is thus an exceptionally valuable instrument for development, the United States needs to commit sizeable additional funds to that institution and push ahead with the proposed Fifth Replenishment. Several steps are needed.

IDA IV

An international agreement for the Fourth Replenishment of IDA was reached in September 1973. In July 1974, the Congress authorized U.S. participation. The U.S. share of the $4.5 billion IDA IV was set at 33% of the total, or $1.5 billion, down from previous U.S. shares which had averaged 41 percent since the inception of the organization in 1960.

While the IDA IV Agreement was designed to support new lending commitments over the period FY 1975-77, it gave donors the option of deferring their initial contribution to FY 1976, and the option of paying in four installments extending through FY 1979. The United States chose to exercise both these options in order to spread out the budgetary cost of IDA IV. Partly because of that choice, the United States has fallen behind other donors in its contribution to IDA IV. Most other donors have now completed their payments to IDA IV, but the United States has made less than one-half of its contribution.

The Administration believes that the United States should play its full share in IDA IV. Hence it is requesting $430 million in appropriations for the Fourth Replenishment -- $55 million in an FY 77 supplemental to complete our first installment, and $375 million in the FY 78 request to make our third installment.

Appropriation of these requests would be of great significance to the potential recipients of IDA loans. While it is difficult to identify precisely who would be affected, two examples of actual FY 1976 loans give an idea of the possible impact. A $22 million loan to Bangladesh helped finance an 18,600 hectare irrigation project which is expected to increase rice production from 93,000 tons to 141,000 tons by 1983, and the annual per capita incomes of some 20,000 farm families from $90 to $120. Additional jobs will also be created for landless laborers and "marginal" farmers. In Pakistan, a $26.6 million project would benefit more than 2 million people in Lahore through improvement and expansion of the city's water supply; an additional 250,000 people will benefit from a 20 percent expansion of the city's sewer system. So while the requested funds may seem small in comparison with IDA's annual lending, now running at about $1.6 billion, they are not insignificant in terms of the very large number of poor people affected.

Despite the rapid inflation of the early 1970s, the burden of IDA upon the United States has remained about the same. In real terms our contribution to IDA has, in fact, declined over the years. Our failure to provide these amounts would also result in raising serious doubts about U.S. intentions under the proposed IDA V Agreement which, as I mentioned yesterday and shall describe in detail in a moment represents a major initiative which the United States can take in our relations with the developing countries.

THE IDA V AGREEMENT

As indicated yesterday, the Administration hopes to make multilateral assistance through the development banks a key component of our efforts in the North/South dialogue. At the heart of this strategy is the proposed IDA V agreement, which we hope to conclude at the sixth negotiating session next month in Vienna.

Since November 1975, five IDA V negotiating sessions have been held -- the last in Kuwait in January. The World Bank originally proposed a $9 billion replenishment, with $3 billion to be contributed by the United States over the

the three years FY 1978-1980. Because of uncertainties over the level of appropriations to be received under IDA IV, however, the United States was hesitant to make any commitments on the overall size or U.S. share of IDA V during the first three donor meetings. With the November elections then approaching, the previous Administration in fact decided not to formalize any U.S. commitments -- nor did it do so during the transition period, when it was felt that the new Administration should decide the United States position.

Having reviewed the situation in detail, the Administration would now propose the following negotiating package on the major IDA issues for consideration by the Congress:

- $7.2 billion from IDA's traditional donors, including $2.4 billion from the United States (the same 33 1/3% share for the United States as under IDA IV);
- Maximum possible contributions from the non-traditional IDA donors: Saudi Arabia, Kuwait and the United Arab Emirates (which would now appear to total at least $500 million, reducing the U.S. share further to about 31%);
- A change in procedures such that the United States (and all donors) will make their pledges subject to appropriations;
- To enable IDA to avoid a hiatus in new lending after July 1, 1977, a voluntary advance contribution procedure (which the United States will accept, but not participate

in).

The Administration would propose to finance a $2.4 billion pledge to IDA V through three equal annual installments of $800 million each, on the same schedule as other donors. Thus, after the FY 1979 appropriations for IDA IV and IDA V have been made, the United States will not again have fallen behind others and will not have to "double up" appropriations for two replenishments during the same fiscal year.

I believe it is in the interest of the United States to support this package. It would provide a reasonable real increase in IDA's ability to transfer resources to the LDCs; indeed, the IDA IV Agreement of $4.5 billion would have to be increased to at least $6.5 billion under IDA V merely to cover losses to inflation over the duration of the two agreements. I would ensure that the overall U.S. share of IDA V would be reduced to no more than 31%, from our IDA IV share of 33%. It would allow IDA to continue making new loans without interruption, while donor countries carry out their formal ratification procedures.

Most important, the proposed timetable enables us to enter the final stages of an IDA negotiation with a much clearer view of Congressional reactions than has been possible in many years. As I indicated yesterday, we welcome the opportunity to discuss the subject in detail at these hearings; and at those scheduled by the Senate Appropriations Committee in early March. We look forward in addition, to extensive consultations with other members of both houses of Congress prior to the Vienna meeting on March 14-16, at which we hope to conclude a final agreement -- a meeting at which, as I indicated yesterday, we hope to be accompanied by representatives from the Congress.

All other major donor countries with one minor exception (on which we are working actively), have indicated that they will support an IDA V along the lines which we have proposed today. The Administration profoundly believes that such a replenishment is essential to promote a wide range of U.S. humanitarian, security, political and economic interests. We urge the Congress to provide an early indication of support for the suggested approach.

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FOR RELEASE UPON DELIVERY

STATEMENT OF THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY-DESIGNATE
FOR INTERNATIONAL AFFAIRS
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
OF THE HOUSE APPROPRIATIONS COMMITTEE
FEBRUARY 16, 1977 AT 10:00 A.M. EST

1. Mr. Chairman and Members of the Committee, it is an honor to appear before you today to begin the testimony of the Carter Administration on the U.S. foreign assistance program for 1977 and 1978. Because these are the initial hearings on our overall proposals for the international development lending institutions, which this Administration strongly supports, and because we are seeking substantial sums for the current and coming fiscal years, I believe that -- before turning to the specifics of our appropriation requests -- it would be desirable to spell out in some detail the basic philosophy and policy approach of the Administration.

2. Before doing so, however, I wish to stress, as I did before the Senate Subcommittee on Foreign Operations last week, the total commitment of this Administration to the closest possible cooperation with the Congress in this policy area. The President has already been actively

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fulfilling that commitment across a wide range of issues, both domestic and international. It is an honor for me to be able to intensify it today, concerning U.S. policy toward the international development lending institutions.

3. In preliminary conversations with yourself and others in the Congress, and with Committee staffs from both House and Senate, I believe that progress has already been made toward resolving some of the major issues which have been outstanding in the recent past.

4. First, we fully accept your view that U.S. contributions to the international development lending institutions be pledged "subject to appropriations." I have so informed the management of the World Bank, which is already at work on the adjustments that may therefore be required in its previous operating procedures. I will convey this position clearly to all other donor countries, at a special meeting to be held shortly for that purpose.

5. Second, we will initiate a full review of the lending policies and practices, and the internal administration, of all international development lending institutions of which the United States is a member. As President Carter has indicated on several occasions, and as Secretary Blumenthal affirmed in his confirmation hearings before the Senate Finance Committee, this Administration strongly supports the extension of foreign assistance through

international development lending institutions. But, in keeping with the priority which the Administration attaches to efficiency in management and minimization of administrative costs, we will look carefully at all aspects of the banks' operations and report our findings to you as soon as our analyses can be completed. The Treasury Department will attach very high priority to this review. And we will appoint U.S. Executive Directors to each of these institutions who will forcefully convey U.S. policy to them.

6. Third, we accept the proposal in your letter of February 2 to Secretary Blumenthal, co-signed by Chairman Daniel Inouye of the Senate Subcommittee, that the fiscal year 1978 budget submission should seek appropriation of all callable capital for the international financial institutions. We have informed the Office of Management and Budget of our desire to thereby revert to the traditional approach to this issue.

7. Fourth, we particularly welcome the opportunity to discuss in these hearings a <u>pending</u> U.S. international financial contribution. Mr. Chairman, we recognize the problems created in the past by international pledges made by Administration officials <u>prior</u> to the conclusion of adequate consultations with the Congress.

As a result, relationships between the Administration and Congress have been uneasy, and there has been a growing uncertainty on the part of other governments -- both donors to the international development lending institutions, and recipients of the funds in planning their development program -- about the follow-through of the United States in fulfilling its pledges. This Administration is committed to eradicating those problems, by ensuring that full consultation with the Congress precedes every pledge of U.S. funds to an international development lending institution.

8. It would probably be impractical to hold formal hearings, in all cases, to achieve this purpose. In some instances, it would seem that extensive informal consultations could do so. In launching this new spirit of consultation, however, we are delighted that the opportunity has arisen for formal discussion -- both in these hearings before your Committee, and before the Senate Committee in early March -- of the U.S. contribution to the fifth replenishment of the International Development Association ("IDA V") before we meet with the other donor countries, in Vienna on March 14-15, to try to complete that arrangement.

9. The objective of this Administration, across the entire range of international economic issues, is to develop sustainable policies. We will avoid making pledges, or proposals, in international forums which are unlikely to

command support with our own Congress and our public. We believe that such an approach will strengthen the credibility, and hence the capacity for influence and leadership, of the United States in international affairs.

10. With the several steps which have already been taken, we believe that we are moving toward a firm partnership with the Congress in this important policy area. In that vein, we note with pleasure the comment in your letter of February 2 to Secretary Blumenthal, Mr. Chairman, that "Congressional support for the development finance proposals of the Executive Branch will be enhanced" by commitments such as we have just made.

11. We are also heartened that the Budget Committees of both the House and Senate, after contemplating cuts in the supplemental appropriations for fiscal year 1977 under consideration today, have decided to include the full amounts in their Third Concurrent Resolution. We sincerely hope that these

several expressions of support for the program do indeed presage a new period of the closest cooperation between us, beginning with the supplementary appropriations for fiscal 1977 and the regular appropriations for fiscal 1978.

12. President Carter has personally and publicly indicated his strong support for the legislation before you today. Speaking to a news conference in Plains, after a half-day session on the whole range of international economic issues last August 18, he stressed his firm belief that the United States should make its full contribution to the on-going activities of the Inter-American Development Bank, the Asian Development Bank, and the World Bank family -- the appropriations which we seek today. President Ford also indicated his full support for these appropriations by including all of them, except those reflecting our decision to seek appropriation of the callable capital needed in fiscal 1978, in his final budget proposals.

U.S. Support for Development

13. There are four basic reasons why this Administration supports so strongly the proposed U.S. contributions to the international development lending institutions. It is our firm belief that they support fundamental U.S. humanitarian, security, political and economic objectives.

14. Poverty and misery remain endemic in many parts of the world. Our very spirit as a nation requires that we do our part toward alleviating those conditions. When World Bank loans bring drinkable water to urban slums in Lima and Lahore, for the first time, our <u>humanitarian</u> purposes are advanced. So are they when an Inter-American Development Bank loan brings water, health and education facilities to rural Colombia, and when an IDA loan brings primary education to rural Malawi. We simply cannot turn our backs on the basic human needs which go unmet for millions of families around the world, needs which demonstrably can be met effectively through the international development lending institutions.

15. At the same time, our most urgent <u>security</u> concerns relate closely to effective development of the poorer countries. International instability in such countries, which can often be fostered -- or even produced -- by lack of economic progress, can create international tension and conflict which in turn can draw the United States into dangerous international situations. The efforts of this Administration to curb both nuclear proliferation and massive transfers of conventional arms can be significantly promoted by effective U.S. leadership of the international development process. And there is a close, albeit sometimes indirect, relationship between the process of development and the ability and

willingness of the developing countries to provide us (and our allies) with oil and other vital resources on terms which are consistent with our own security requirements. Hence U.S. security, as well as humanitarian, concerns are linked to our role in supporting development.

16. These security concerns blend into even more far-reaching political relationships. We are at this moment at an historic movement in relations among the industrialized and developing countries -- now taking place through the "North-South dialogue." In that discussion, the developing countries are seeking wide-ranging accommodation by the industrialized countries to their many needs. The Administration is reviewing extensively that whole range of issues, with the goal of developing a comprehensive set of proposals which would meet those needs in ways consistent with our own national interests and ability to contribute.

17. One conclusion is already clear, however: direct resource transfers must play a central role in our response. Such transfers, particularly those channeled through the international development lending insitutions, can be focused on those who need them most. They can be linked to projects and programs which assure that they will be used effectively. The costs of providing the transfers can be shared equitably among

the donor countries, thereby avoiding frictions with our traditional allies as well as ensuring fairness in meeting the needs of the poor. Such results cannot be assured through some of the other devices proposed by the developing countries, and as widespread debt relief and artificial increases of commodity prices. Hence we believe that a constructive U.S. program of foreign assistance, and particularly a program of enthusiastic support for the international development lending institutions, is of consummate political importance to the United States across this entire range of North-South issues.

18. Finally, and once more closely related, U.S. support for development serves some of our most important <u>economic</u> objectives. The developing countries now represent a major market for U.S. exports, and in recent years have been one of our fastest growing markets. Similarly, they host a sizable share of U.S. foreign investments -- a share which, in recent years, has been growing for our manufacturing companies. And, as already noted, these countries provide a large share of a large number of the growing list of industrialized raw materials for which the United States depends heavily on imports.

19. In short, U.S. support for development in the poorer countries is inextricably linked to a wide range of fundamental U.S. interests. These interests relate both to our own economy, and to our overall foreign policy. They require our commitment to a constructive program of international

economic assistance.

20. Traditionally, "development" has been defined as rapid expansion of Gross National Products and other aggregate economic indicators. On these criteria, the post-war record has been one of stunning success. During the 1960s, the developing world exceeded the ambitious growth targets of the first Development Decade. Since the mid-1960s, the exports of manufactured goods of these countries -- excluding OPEC -- have grown by about 25 percent annually, raising their share of world manufacturing output from three percent to over seven percent. Many countries have "graduated" from the rolls of aid recipients to where they can now rely on the private markets for capital, and some have even begun to extend assistance themselves. The post-war record of development is indeed unprecedented in human history. It enables us to reject fully the despair which all too often creeps into discussions of the outlook for the developing world.

21. Our concept of "development" has now broadened, however, to encompass much more specific objectives: satisfaction of basic human needs, reduced rates of unemployment, better distribution of income and greater agricultural productivity. Even on these criteria, there are numerous "success stories." But it is clear that these goals can be met more effectively, and more quickly, when they are the explicit targets of development lending.

22. For example, jobs can often be created more rapidly when technology is consciously adapted to the labor-intensive conditions in most recipient countries. In response to your initiatives, Mr. Chairman, detailed information has been obtained from all of the international development lending institutions regarding their plans in this regard for the future. The IDB Board of Directors has already passed a policy statement making clear that the provision of "appropriate technology" is a major component of its development strategy, and has created a standing committee on the subject to provide guidance on the subject to the Bank staff. The staff of the ADB has participated in a regional meeting on "intermediate technology" and has recently included components thereof in several of its loans. One example of this new approach is the grant provided by the ADB, in May 1976, to the International Crops Research Institute for the Semi-Arid Countries, for a comprehensive survey to identify and assemble the presently known and applicable agricultural implements used in the semi-arid tropics. The grant will also support research into the development of improved animal-drawn farm equipment and implements.

23. A second key area is increased production of food, and rural development more broadly. The progress of the international development lending institutions here has been even more impressive:

- -- Agriculture accounted for the largest share of IBRD loans to any sector in FY 1976 (24%). It has received twice as much support, in real terms on an annual basis, in FY 1974-76 as in the previous five years. 55% of this program in the last three years has focused on the rural poor.
- -- Since its inception, IDA has lent more funds to agriculture than to any other sector (29%). That ratio reached 31% in FY 1973-76.
- -- About 25% of all IDB loans have been to agricultural development projects. Recently it has focused heavily on assisting poor farmers through agricultural credit programs, and estimates that 2.5 million rural citizens have been helped by loans to cooperatives and similar organizations.
- -- 26 percent of ADB lending in 1976 went to agriculture.

24. Specific projects reveal the contribution of these programs to meeting the needs of the rural poor far better than the aggregate statistics. A $57 million IDA loan to India is bringing rural electrification to 55,000 small farmers, providing power for irrigation pumping, small industries and

residential and street lighting in over 6,000 villages. A $22 million IDA loan to Bangladesh helped finance an 18,600 hectare immigration project, which will boost rice production by more than 50 percent in six years and raise annual per capita incomes of 20,000 farm families from $90 to $120. An IBRD loan to Egypt is helping to create 10-15,000 jobs in fruit and vegetable production. An ADB loan of $14 million to Afghanistan will increase wheat production by 323,000 tons and seed cotton production by 32,500 tons, raising income of about 200,000 farmers by $17-80 per hectare. The development banks are thus actively, and successfully, pursuing programs to bring major help to the rural poor and to farm production throughout the developing world.

The Role of the International Development Lending Institutions

25. There are three major reasons why the Administration believes that the international development lending institutions are particularly effective instruments for pursuing the several U.S. interests in development which I have already outlined. First, as I have just been indicating, is their demonstrated effectiveness in helping to achieve the several key goals of development strategy. Indeed, the billions of dollars which the U.S. has contributed to these institutions are among the best investments which this country has made.

26. One reason for this effectiveness is that the international development lending institutions can -- and do -- insist on sound projects and programs in the recipient

countries themselves. They can do so with particular effectiveness because of their political independence and collective representation of donor interests. Hence they are a good bet to carry out programs which will effectively implement our wide-ranging interests in the development process.

27. Second, and closely related, use of the international development lending institutions to channel development assistance lessens the political risks which are inherent in any donor-client relationship. Insertion of an independent intermediary between lenders and borrowers significantly depoliticizes the process, and enhances the likely developmental impact.

28. Third, use of the international development lending institutions assures burden-sharing between the U.S. and other donors. The U.S. share of the lending levels of each of the banks is declining:

- -- in the IBRD, from an original 41 percent to about 19 percent of the current selective capital increase.
- -- in IDA, from an original of 43 percent to about 31 percent in the current proposed replenishment.
- -- in the IFC, from an original 33 percent to 23 percent of the currently proposed replenishment.
- -- in the Asian Development Fund, from 28 percent to 22 percent.

-- in the Fund for Special Operations of the IDB, from 100 percent of convertible currency contributions at first to about 80 percent now

29. It will be the policy of this Administration to encourage other countries to continue to increase their share of the financing of these institutions. We will seek involvement by new donors, notably OPEC countries but other rapidly developing countries as well. We view this burden-sharing as a long-run process of adjusting to underlying changes in the relative economic strength of nations, and believe that the international development lending institutions are an ideal means through which these changes can be translated into actual contributions to the development process.

30. Indeed, we view the individual international development lending institutions increasingly as components of a network which stands at the center of the international development process. Their loan disbursements now amount to over 20 percent of all official development assistance flows, but their commitments represent a share almost twice as high. For the reasons already indicated, they are extremely effective instruments for supplying development. The IBRD, IDA and the IFC operate globally and emphasize different problems -- the more advanced developing countries in the case of the IBRD, the poorest in the case of IDA, and the role in the private sector in the IFC. The IDB, ADB and African Development Bank attend to the particular problems of their regions. More coordination among the banks is needed. But as they mature further, we can look to them

to play a critical and growing role in the entire development process.

The 1977 Supplemental

31. The most urgent business before us is the supplemental appropriation for fiscal 1977. It is urgent because, without these appropriations, the Inter-American Development Bank and the Asian Development Fund would shortly have to suspend making commitments to the neediest borrowers, and because U.S. support for IDA -- and hence our position in the upcoming IDA V negotiation -- would be thrown into serious doubt.

32. There are three avenues through which the IDB obtains capital to finance borrowing countries in Latin America. It uses the paid-in capital of its donor members to extend "hard" loans. It uses the callable capital subscribed by donor members as backing for borrowings in the private capital markets, the proceeds of which are loaned out. And it channels contributions to its Fund for Special Operations to the poorest countries in the region on concessional terms.

33. But the Bank has in fact exhausted its hard currency resources available for ordinary loan commitments. No further capital subscriptions by other countries can become effective under the replenishment until the United States makes the subscriptions for which we are seeking appropriations. This situation results from arrangements necessary to prevent the U.S. vote from falling below 34.5 percent, thereby causing the United States to lose its veto in the Fund for Special

Operations. In the Fund for Special Operations, resources are available for anticipated operations only through April. All other member countries have contributed to the first installment of the current replenishment, but the United States contribution is essential to make the replenishment effective since it requires no less than 75 percent of the total contribution before the installment can be committed.

34. The FY 1977 supplemental bill also contains $25 million to complete the $150 million U.S. contribution to the initial resource mobilization of the concessional Asian Development Fund. As of today, that Fund has only $17 million available for new loan commitments to its poorest Asian members -- the equivalent of less than two weeks' commitments. Most other donors have completed their contributions to the 1973-75 resource mobilization of the Fund, and most have made their first contributions to the 1976-78 ADF replenishment. But further contributions from these donors will, under the current replenishment resolution, not become available to the Fund until the United States makes the contribution requested in the FY 1978 appropriations bill. Since this would not occur until after October 1, the $25 million being requested for the ADF in the FY 1977 supplemental bill is likely to be its only new source of funds over the next six months.

35. The final item in the supplemental request is $55 million for IDA IV, which is closely related to the forthcoming negotiation on IDA V which I mentioned at the outset of this testimony. As I indicated then, the Administration fully accepts the decision of the Congress that the U.S. pledge to that replenishment be made

"subject to appropriation." We believe that this approach is fiscally prudent, as well as a necessary element in the new structure of cooperation between Congress and the Administration which we seek to forge.

36. In all candor, however, I must report that this decision has caused some uneasiness on the part of other major donor countries. Indeed, I have agreed to their request to attend a special meeting with them in Paris, tentatively scheduled for February 25, to explain and defend our new approach prior to the scheduled negotiating session in Vienna on March 14-15. It is my firm belief that this concern is indicative of a deep concern on the part of both donor and recipient countries over the willingness of the United States to play its fair share in IDA, and perhaps more broadly. Indeed, this concern is a major element underlying the decision of this Administration, through working more closely with the Congress, to henceforth make proposals internationally only when we have reasonable assurance that those policies are sustainable domestically.

37. At the same time, the confidence of other countries in the sustainability of our policies would be enormously enhanced by early action on the IDA IV (and other) supplemental requests. Positive action would provide tangible evidence of a new working relationship within the U.S. Government. Coupled with the extensive discussions between Congress and the Administration which will have gone into

would make a major contribution to early progress for several of the basic thrusts of President Carter's foreign policy. In addition, it would prove of great value in supporting a constructive and sensible U.S. position when the North-South dialogue resumes in the next few weeks.

38. Hence there would be major political benefits for the United States from early Congressional action on the FY 1977 supplemental approriations. But the fundamental reason why we urge their support is that the money is needed badly by the poor people in developing countries for which it would be spent. We urge you to approve the proposed contributions of $540 million, of which $340 million would produce budget outlays and $200 million represent callable capital. All of these sums have, of course, been authorized by the Congress, included in the budget proposals of both President Carter and President Ford, and included in the Third Concurrent Resolution by the Budget Committees of both the House and Senate.

39. The supplemental also requests an appropriation of $30 million in Israeli pounds for the U.S. contribution to the endowment of the Israel-U.S. Binational Industrial Research and Development Foundation. The Foundation's endowment will be created by contributions of $30 million in Israeli pounds from each government. The United States share will be derived

from simultaneous prepayment by Israel of a portion of its PL-480 local currency debt to us. There will be no dollar outlay. An appropriation is necessary for the United States to participate, however, because Israel is no longer an excess currency country.

Appropriation Requests for FY 1978

40. I would like to turn now to the issue of U.S. funding for the continued operations of the development banks. We are requesting appropriations of $2,616.2 million for them in FY 1978. Of this total, $1,602.3 million would require Treasury outlays and $1,013.9 million is in the form of callable capital. Callable capital will allow the banks to raise funds in international capital markets, but in all likelihood never will result in actual expenditures from the U.S. Treasury. The requests consist of:

World Bank Group

-- $523 million for the first of three U.S. installments for a selective capital increase for the International Bank for Reconstruction and Development ($52.3 million of paid-in capital and $470.7 million of callable capital);

-- $44.6 million as the first U.S. installment to the first replenishment of the International Finance Corporation since its establishment in 1956;

-- $375 million for the third U.S. installment of the fourth replenishment of the International

-- $800 million as the first U.S. installment of the proposed fifth replenishment of the International Development Association, if after discussion with you and others in the Congress we decide to proceed with IDA V on that basis.

Inter-American Development Bank

-- $400 million for the third installment of the present replenishment of the Inter-American Development Bank's capital ($40 million of paid in inter-regional capital, $160 million of callable inter-regional capital and $200 million of ordinary callable capital);

-- $200 million for the second installment of the replenishment of the resources of Inter-American Development Bank's soft loan window, the Fund for Special Operations.

Asian Development Bank

-- $203.6 million for the first of four U.S. installments to the second replenishment of the ordinary capital resources of the Asian Development Bank ($20.4 million of paid in capital and $183.2 million of callable capital);

-- $60 million as the first of three U.S. installments to the first replenishment of the resources of the Asian Development Bank's soft loan window, the Asian Development Fund;

African Development Fund

-- $10 million to the resources of the African Development

41. Detailed discussions of these appropriations requests are contained in the statements of the individual institutions that will be presented to the Committee in the course of the next two days. Each represents the U.S. share of a multinational funding effort in which our contributions have been shrinking steadily as a percentage of the whole, as I indicated earlier.

42. In closing this statement, I would like to discuss directly the magnitude of our request for FY 1978, which represents a sizable increase over past years. There are essentially five reasons for the jump:

a. Rapid rates of inflation require large increases in nominal contributions simply to keep the real value of assistance from declining. For example, the IDA V package would have had to total at least $6.5 billion simply to maintain the real value of the IDA IV total of $4.5 billion.

b. Our decision to revert to the traditional procedure of appropriating all callable capital, in response to your proposal, increases the magnitude which must be included in the budget.

c. A bunching of U.S. contributions, caused mainly by previous decisions to (i) begin the U.S. contribution to IDA IV a year later than other donor countries and (ii) stretch that contribution over four years instead of the usual three. As a result, appropriations are needed for both IDA IV and IDA V in FY 1978 (and again in FY 1979).

d. The <u>growing importance of the North-South dialogue</u>, and the concomitant need for the United States to take positions in that forum which are both constructive and supportive of overall U.S. interests. As I indicated earlier, increased assistance is far superior to such other proposals, being made in this context, as generalized debt relief and indexation of commodity prices.

e. Most important, the <u>increased needs of the poorer countries due to (i) the world recession and (ii) higher oil prices</u>. These cyclical factors have superimposed heavy new burdens on those countries, whose structural needs are already immense. To an important extent, they stem from our own economic mismanagement -- as well as OPEC's increase of the price of oil. Hence the need for development finance has risen sharply for the years immediately ahead, and our proposals for FY 1978 seek to respond prudently to them.

43. Mr. Chairman and Members of the Committee, the Carter Administration strongly supports these proposed contributions to the international lending institutions. We believe that development of the poorer countries is of utmost importance to U.S. humanitarian, security, political and economic interests. We believe that foreign assistance can play a vital role in promoting development. We believe that the international development lending institutions are an extraordinarily valuable instrument for channeling such assistance. The President will be

addressing these issues personally, on a number of occasions, over the coming months. We urge you to support the funding requests which are under discussion today, and we look forward to the continuing opportunity to discuss with you, in depth, the whole array of underlying issues.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

February 15, 1977

MARY BROOKS RESIGNS AS DIRECTOR OF THE MINT

Mrs. Mary Brooks has resigned as Director of the Mint effective February 11, 1977.

In a letter to President Carter February 1, Mrs. Brooks said:

> My dear Mr. President:
>
> With this letter I respectfully tender my resignation as Director of the Mint effective on February 11, 1977.
>
> I have been very proud to have served as Director of the Mint the past seven and one-half years. It has been a most challenging and rewarding time of my life and I do look with pride over the many accomplishments we were able to make.
>
> I do extend my best wishes to Secretary Blumenthal and members of his staff and my warmest wishes to you and your family. I know you will go down in history as one of our greatest Presidents.

In his reply on February 9, President Carter said:

> To Mary Brooks:
>
> I have your letter and I accept your resignation as Director of the Mint, effective February 11, 1977, as you requested.
>
> Throughout your public service, you have carried out your responsibilities with dedication, energy, and purpose and have truly earned the respect of your colleagues in Government. I know that in the years ahead you will be able to look back with pride on your many accomplishments.

As you prepare to return to private life, you may be sure that you take with you my best wishes for every future success and happiness.

Mrs. Brooks intends to return to Idaho where she operates a sheep and cattle ranch.

Last month Mrs. Brooks received the Alexander Hamilton Award, the highest award a Secretary of the Treasury can bestow in recognition of superior and unusual leadership in the work of the Department. She is the first woman to have received this award from Treasury.

The award cited Mrs. Brooks for her imaginative and innovative leadership of the Mint's diverse operations conducted in seven field installations.

During her tenure as Director, production of United States coinage virtually doubled, rising from seven billion coins in 1969 to over 13 billion coins in 1975.

In 1971 she shepherded legislation through Congress to launch the Eisenhower dollar, the first dollar coin to be minted in 36 years. In celebration of the Bicentennial, the Mint conducted a national coin design competition to re-design the reverses of the quarter, half-dollar and dollar and implemented a nationwide marketing program of the silver coins.

With a deep commitment to historical preservation, Mrs. Brooks led the move to preserve the Old San Francisco Mint building and supervised the extensive interior and exterior restoration of the National and State Landmark Building. The building now houses the Mint's extensive computer system and administrative offices as well as the Old Mint Museum.

She also directed restoration of seven Tiffany glass mosaics of great artistic merit and value from the old Philadelphia Mint. They are presently mounted in the lobby of the new Philadelphia Mint.

Because of a severe run on pennies in 1974, Mrs. Brooks initiated a media campaign that brought out an estimated one and a half billion pennies from jars and dresser tops. This was implemented through thousands of banks, schools and private citizens.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. February 15, 1977

TREASURY TO AUCTION $2,250 MILLION OF 4-YEAR 1-MONTH NOTES

The Department of the Treasury will auction $2,250 million of 4-year 1-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.

Details about the new security are given in the attached highlights of the offering and in the official offering circular.

Attachment

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 4-YEAR 1-MONTH NOTES
TO BE ISSUED MARCH 8, 1977

February 15, 1977

Amount Offered:

To the public	$2,250 million

Description of Security:

Term and type of security	4-year 1-month notes
Series and CUSIP designation	Series H-1981 (CUSIP No. 912827 GN 6)
Maturity date	March 31, 1981
Call date	No provision
Interest coupon rate	To be determined based on t average of accepted bids
Investment yield	To be determined at auction
Premium or discount	To be determined after auct
Interest payment dates	September 30 and March 31 (first payment on September 1977)
Minimum denomination available	$1,000

Terms of Sale:

Method of sale	Yield Auction
Accrued interest payable by investor	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less
Deposit requirement	5% of face amount
Deposit guarantee by designated institutions	Acceptable

Key Dates:

Deadline for receipt of tenders	Wednesday, February 23, 197 by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds	Tuesday, March 8, 1977
b) check drawn on bank within FRB district where submitted	Thursday, March 3, 1977
c) check drawn on bank outside FRB district where submitted	Wednesday, March 2, 1977
Delivery date for coupon securities	Tuesday, March 8, 1977

FOR IMMEDIATE RELEASE FEBRUARY 10, 1977

OFFICE OF THE WHITE HOUSE PRESS SECRETARY

THE WHITE HOUSE

REMARKS OF THE PRESIDENT
AND
INFORMAL QUESTION AND ANSWER SESSION
AT THE DEPARTMENT OF THE TREASURY

AT 1:38 P.M. EST

SECRETARY BLUMENTHAL: Mr. President, ladies and gentlemen:

Mr. President, I guess I don't need to begin by saying we are glad to see you. (Laughter)

We are meeting you in the largest room in this building, the Cash Room. And you can see that we have gone one better on what history tells us happened at the time of the inauguration of President Grant, when the whole Inaugural Ball -- the entire one -- took place in this room. That compares to the six ballrooms that your Inaugural Ball took place in.

We are delighted to see you. We are your closest neighbor.

I was extended a cordial welcome when I came by the many people in the Treasury who are eager to work with you and with us to do a good job.

We are just across West Executive Avenue, and you have shown us that it is only a few feet. We are very happy to have you here.

THE PRESIDENT: Thank you. I am glad to be here. Thank you very much.

I am very glad to be here, Mike. You are my closest neighbor, as you know. A lot of my people in Georgia always felt that if I came to this building, it would probably be because of income tax evasion or something like that. (Laughter)

I would imagine that standing on this stage are more Georgians than there were at U. S. Grant's inauguration in this room, right after the Civil War. We had about 60,000 people who came to the Inaugural Balls this time, and many of them were my close and personal friends whom we had met and gotten to know during the long, tedious, laborious but enjoyable and openly successful campaign.

I don't think many Presidents have taken the time to come and meet with the key employees and leaders of our government. I consider it a great honor to be able to come and meet with you for a few minutes.

One of the major successes that I have already realized is a choice of a superb Cabinet. I had an

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opportunity, as you know, to select a Secretary of Treasury from literally thousands of people who were well qualified. There is no doubt in my mind that I chose the best person in the United States to be your leader. I have complete confidence in him, and I am deeply grateful that Mike Blumenthal was willing to come work with you and with me to make the Treasury Department successful, and I am sure he will succeed, along with us.

There is literally no department in government which touches more people in a more sensitive way than does yours. I think you know that a lot of the attitudes that people form about public administration and leadership and about the attitude of their own government towards them is derived from the Treasury Department. This is so important to me because in the last few years our country has been deeply embarrassed.

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There has been an impression that swept the Nation that our Government was neither competent nor honest, nor had sound judgment, and that is because of the mistakes of a very few people who were in leadership positions. The consummation of the Vietnam War, the revelations that the CIA and sometimes the FBI violated the law,and the Watergate revelations, really shook the people of this Nation and helped to destroy their good relationships and opinion of the Federal Government.

But at the same time there remain within the hearts and minds of Americans an unshakeable patriotism and an unshakeable hope and belief that all those serious mistakes could be repaired, that difficult questions could be answered and that we would approach the future with a renewed commitment to common principles that have bound our lives together.

I have been lucky enough to have been elected President of this great Nation. I am no better than any of you. I am sure there are many people in this room who are better qualified than I am in many ways. I have a lot to learn. I have only been on the job now about three weeks. Some of you have been here for years.

I was interviewed yesterday at the Commerce Department by Dr. John Taylor, who had been on the job since 1929, for 48 years. But I share with you an equal responsibility to represent the people of our country well. Whether I succeed or fail depends on you, and whether or not we can form a partnership as tangible and continuing and mutually respectful.

I think the country is ready for some substantial changes. I want to be sure that every one of those changes is an improvement. There is no way that I could sit in relative isolation in the White House and decide what is best for our people in the Treasury Department. You have been here. You have seen the mistakes. You have seen the achievements.

The things that are good and proper and efficient and effective ought to be preserved and enhanced. The things that may have been equally adopted for 15 or 20 years, which can be improved, we ought to improve them, and if there are things that ought not to be here at all, we want to eliminate them.

We want to get authority very shortly to reorganize the structure of Government in broad generic terms, transportation, electronic data processing, printing, personnel management, on the one hand; internal reorganization within departments like your own, and in addition, the shifting of major responsibilities among departments.

I want to be very, very thorough and very, very careful. I don't want to make any mistakes. The best way to insure that that hope is realized is to use your advice and your counsel and your suggestions and your criticisms.

You need not have any fear of the prospective changes that might be brought forward. No one will be discharged in the entire Federal Government as a result of reorganization. No one in the Federal Government will lose seniority or pay status. We might very well find it necessary on occasion -- it would be rare, I think, relating to the Treasury Department --

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to transfer people from one job to another. If that should occur, any training required would be fitted in with your own capabilities and obviously would be paid for by the Government.

We are now embarked on some very substantial analyses to make Government better. We have already introduced a brief economic stimulus package, equally balanced between 1977 and 1978.

We are following that up with a very comprehensive energy policy. Our Nation is the only one developed on earth that doesn't have some comprehensive energy policy. By the 20th of April we will have completed that study and we will submit to the Congress some legislation to implement our recommendations on that day. With former President Ford and Vice President Mondale as chairmen, it will be an organization designed to save energy. Serving in that group will be members of my Cabinet, key Members of Congress and key representatives from different groups around the Government. In addition, we hope to set up State functions in all 50 States to hold down the waste of energy.

By the 1st of May we will have a comprehensive study completed on welfare reform. Later on this year, under the leadership of Mike Blumenthal, we will have a comprehensive analysis completed on income tax reform.

We don't want to do things in a haphazard way, but the country is ready for some real analysis so we can say what needs to be kept and what needs to be changed for the better. Obviously, anything we do will be carefully scrutinized by the public and by Congress, and that is the way it ought to be.

I would like to conclude my statement by saying this: I hope that you will participate in an active way, that you will help overcome the weaknesses or shortcomings that might be apparent to you in my leadership or in the leadership of Mike Blumenthal and others. It is a time for a maximum degree of cooperation and harmony.

As you deal with your clients, the people of your country, whether it might be in revenue sharing or whether it might be in enforcement of the laws that relate to drugs or whether it might be in Secret Service protection or whether it might be in Treasury or whether it might be in overall international trade agreements, no matter what it is, I hope that you will always remember, as I will try to do, that we are not bosses of anyone; we are the servants to the American people.

I hope I can exemplify this attitude in such a way that it might inspire you to do the same thing. I have tried to eliminate some of the artificial trappings and respect that is openly paid to me. I feel that the office of the Presidency is substantial enough and has an adequate amount of respect already.

I want all of us to take the demeanor of a government as it should be in a democratic society. We are servants, not bosses. And to the extent we can recognize whom we serve -- the people of our country -- in a fair way and an enlightened way, I think we will all be successful.

I have a few minutes now. If you have any questions, I will try to answer them. If I can't answer them, I will let Mike Blumenthal answer them.

QUESTION: Mr. President, I would like to know whether you are going to come back here, because we don't have a chance to see you.

THE PRESIDENT: Let me say this: I doubt if the people in Customs have seen very many Secretaries of Treasury. Let me let Mike Blumenthal come and get acquainted first, and later on I will try to come.

When I got elected Governor of Georgia, I had a similar desire to meet with the people who work in the government, so I went over to our Revenue Commissioner's office. I was going through from one office to another, and there was a very old gentleman there who obviously had been there 20 or 30 years. I shook hands with him and I said, "Have you ever met a governor before?" He said, "I haven't even met a revenue commissioner before."

I want you all to insist that Mike Blumenthal come, and I will come when I can.

QUESTION: In your plan for reorganization, do you foresee any changing of the law for the Treasury Department? Specifically, do you see us taking on any new responsibilities or losing any old ones?

THE PRESIDENT: I can't answer that question yet. What we will do, first of all, is get the authorizing legislation and then start an analysis. The staff work will be done by the Office of Management and Budget primarily. I will probably appoint someone directly to represent me as a coordinator of the entire process.

But nothing would be done, obviously, without the full participation of you who are involved, working through Mike Blumenthal, before a change was made.

I can't answer your question about specific changes that might ultimately be recommended to the Congress.

What I am asking for is the same authority that was given to all the Presidents from Franklin Roosevelt in the early thirties right on up through Richard Nixon.

We have introduced a bill now that I think will get rapid passage in the Senate. And I think without question we will get approval in the House that will restore that authority.

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What it does mean, in effect, is that I can present to the Congress a reorganization plan whenever I develop one on a specific subject. And if the Congress doesn't veto that plan in either house in 60 days, it automatically goes into effect.

The only change that I am requiring or requesting, compared to the previous authority, is that while the bill or plan is still in committee I would have the right to amend that proposal before it gets on the floor. In the past, once it was submitted to Congress, no amendments were permitted. But with that one exception, it will be the same as the authority given to Richard Nixon, for instance, when he came in office in 1969.

I can't answer your question about specific changes yet.

QUESTION: Mr. President, I read in the paper that you are asking the Cabinet Members to read their regulations before they issue them. I think it might be interesting to see if the Cabinet would fill out the new short forms on income tax regulations.

THE PRESIDENT: I have noticed, as a peanut farmer, that the forms get simpler and simpler every year. I have just had my second CPA to help me fill it out. (Laughter)

I think that you will see that if our economic stimulus package proposal goes through, giving a standard deduction of $2800 to every family, that it will indeed be much simpler. We h /e some plans already that we almost proposed to Congress that would be included in a comprehensive income tax reform that I hope to make very simple after this year.

If the Congress adopts just this first step proposal, 75 percent of all the taxpayers of our Nation will be able to fill out by themselves the income tax returns. This is a big step forward.

I know that my request to the Cabinet Officers to read all the regulations that they are issuing is a very, very onerous task. I also know that my request that the ones who are responsible for writing the regulation sign it might create some problems. But I want to make sure that the regulations that come out from the Federal Government, first of all, are necessary; secondly, are as brief as possible; and, third, are worded in plain and simple English and also accurately represent the policies of the Secretary or the Members of the Cabinet and my own Administration.

If it takes all weekend for the Secretary of the Treasury to read those regulations, I would like for him to do it (laughter) -- not on a personal basis, but I think it is very important that the Secretaries of HEW and HUD and Transportation and Treasury actually read those regulations for a while to see the enormous volume that comes out. Then I think they will be able to call a meeting of those who are responsible for writing the regulation and say, "Why can't we cut down on some of this volume? Why can't we simplify the language and why can't we leave more responsibility and judgment up to our Federal workers to exercise common sense?"

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I am going to be doing the same thing at the White House level. I have already spent a good bit of time studying the overall procedure by which Government regulations are issued. I have already had a meeting with the members of the Government Operations Committee in the Congress to start working out some changes in the law that might reduce the onus on the department in the writing of regulations.

I never dictate a letter. Almost all of my memoranda are written on one side of one sheet of a 5 by 8-inch pad. I can write it very quickly, send it out, and it is done. I hope that every person in the Federal Government, not will quit dictating (laughter) but will try to abbreviate the enormous volume of paperwork.

I would also hope -- to close out a long answer to a very good question -- that in the reports required from people Around the country on basic data, that we might have several of our departments get together and share the preparation of requisite forms so that a businessman who does have to submit information about his own affairs could fill out one form and let HUD, HEW and EDA and Transportation and others share the information that comes in on that form.

I am determined to accomplish this before I go out of office. If I do, my administration will have been successful even if I don't do anything else. (Applause)

QUESTION: Mr. President, your intention to get a handle on the Federal Government and make it more responsive to the average citizen, as a part of that process of getting a handle on it there are normally thousands of Government workers who are not in the supergrade or higher levels of Government who feel that they want to make this type of response as a kind of contribution to the citizens groups, and yet we are -- to use the proverbial word -- weighed down so heavily by the mass of bureaucracy. As part of your intention to get a handle on Government, will there be the kinds of programs that will allow what I like to refer to, or like to refer to it as such, but it is a wasteland of power and energy. We want to contribute, but how do we get out of that impossible feeling?

THE PRESIDENT: Let me answer very quickly. When I became Governor of Georgia, I ran on a platform similar to my Presidential platform of reorganizing the Georgia Government. I thought that the civil service workers would be my major obstacle in reorganizing the Government.

When I got in office, we turned for help to the civil servants, who were by far the most knowledgeable people. They were involved in the initial stages of the preparation of proposals for improvement. They became my strongest supporters because every one of you in this room -- even much more than Mike Blumenthal and Jimmy Carter -- are devoting your whole life to your profession in serving the American people in Government.

You have just got one life to live on earth, and I know you want to do a good job. To be constrained from giving good service by unnecessary paperwork, regulation, complexity of assignment, a lack of specificity about who has responsibility

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for a job, the multiple division of responsibility for the same function among many agencies, those things sap away the abilities that you have to do a good job.

So reorganization is a kind of -- it is not a good word perhaps; I wish there were a better word -- but I think it ought to originate with you.

Any time any of my Cabinet officers bypass the civil servant, at whatever grade in that process, they will be violating my own instructions and making a very serious mistake. It will also be a sacrificial or suicidal mistake, because unless we have your support and your participation and your advice, we are not going to succeed in making a change, even if we want to.

But I would like it to come from you up through your superiors, and ultimately to me.

The other thing we are going to do is this: In 1979 the fiscal year budget will be prepared using zero-based budgeting. This is a procedure that I used in Georgia for four years. It is simple and it works. It puts every function -- whether it has been here 50 years, 5 years, or the first time next year -- on the same basis. You don't just analyze the new proposals for next year; you analyze all the functions that have been there for a long time. That is important.

The second thing is this: that the people deep within the department, the supervisors of just maybe 8 or 10 people, prepare an analysis of what you are doing, how many people you have working for you, how much money you are spending, the ultimate service that you are supposed to be delivering, and your own suggestions on how your performance might be improved.

Now, this would result in tremendous savings, obviously. It would give you an automatic way to express a pent-up hope for more efficient delivery of services that you might have had for 5 or 10 years, and it will let your superiors know that you are striving to do a good job. Ordinarily in government -- I know State Government and I will just speak for it -- if somebody does have a good idea, they are very afraid to propose that idea because they might be rocking the boat or changing the status quo and they feel that they might suffer.

But if there is a standard report, a budgeting form, which is one side of one sheet of paper -- that is all -- you can fill it out with a ballpoint pen, you don't even have to type it, and those contributory, beneficial suggestions work their way up to the top. Then your department heads arrange those suggestions in an order of priority and start at the top and we fund down as far as we can. It will make sure the money that is allocated to you goes further, and it also makes sure that you have a voice in the preparation of the next year's budget.

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Those kinds of changes help to weld together in a cohesive way the newest and most junior employee with the Cabinet officer who is the head of your department, and ultimately to me.

I will do everything I can to make sure that we do have a way to make your own lives more meaningful, to make your own department more effective. My success or failure, as I say, depends almost directly on how much you trust me, how much I trust you, and how closely we are all tied together in a common purpose that can't be severed.

I believe we have the hope among the American people that we succeed, and a good sense of new confidence and good will that exists around our Nation now toward all of us. I just want to be sure that in no way we ever betray that hope and betray that confidence.

Thank you very much.

END (AT 2:03 P.M. EST)

Department of the TREASURY
NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: J.C. Davenport
Extension: 2951
February 16, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES TENTATIVE DETERMINATION TO MODIFY OR REVOKE DUMPING FINDING WITH RESPECT TO CLEAR PLATE AND FLOAT GLASS FROM JAPAN

Acting Assistant Secretary of the Treasury John H. Harper announced today the "Tentative Determination to Modify or Revoke Dumping Finding" with respect to clear plate and float glass from Japan. Notice of this action will appear in the Federal Register of February 17, 1977.

The "Finding of Dumping" in the instant case was published in the Federal Register of May 18, 1971.

Before a tentative modification or revocation of a dumping finding can be issued, Treasury requires that the finding have been in effect for at least two years, that there be established a two-year period of no sales at less than fair value subsequent to the finding, and that price assurances be submitted. After an allowance for oral and written presentations, Treasury will then consider whether to issue a final modification or revocation.

Imports of clear plate and float glass from Japan during calendar year 1975 were valued at $168,000.

* * *

Department of the TREASURY
WASHINGTON, D.C. 20220 TELEPHONE 566-2041
NEWS

Contact: J.C. Davenport
Extension: 2951
February 16, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES COUNTERVAILING DUTY INVESTIGATION ON IMPORTS OF BUTTER COOKIES FROM DENMARK

Acting Assistant Secretary John H. Harper announced today a formal notice of investigation and receipt of countervailing duty petition with respect to butter cookies from Denmark under the U.S. Countervailing Duty Law (19 U.S.C. 1303). Notice to this effect will be published in the Federal Register of February 17, 1977.

Under the U.S. Countervailing Duty Law, the Secretary of the Treasury is required to assess an additional (countervailing) duty that is equal to the amount of the bounty or grant that has been found to be paid or bestowed on the imported merchandise. This action is taken pursuant to allegations that butter cookies imported from Denmark benefit from the payment of a bounty or grant under the European Community's Common Agricultural Policy. A preliminary determination in this case must be reached on or before June 28, 1977 and a final determination must be issued by December 28, 1977.

Imports of the subject merchandise from Denmark were valued at approximately $4 million during calendar year 1975.

* * *

Department of the TREASURY
WASHINGTON, D.C. 20220 TELEPHONE 566-2041
NEWS

CONTACT: Jon G. Taylor
202-566-8419
February 15, 1977

FOR IMMEDIATE RELEASE

The form to be used by taxpayers required to file an international boycott report -- Form 5713, International Boycott Report -- is expected to be available before May 15, 1977, the Treasury Department announced today.

As detailed in Answer A-7 of the international boycott guidelines issued November 4, 1976 (published November 11, 1976 in 41 Federal Register 49923), one copy of Form 5713 should be sent to the Internal Revenue Service Center, 11601 Roosevelt Blvd., Philadelphia, Pennsylvania, 19155, and another copy attached to the taxpayer's income tax return which is filed with the taxpayer's customary Internal Revenue Service Center. Both copies should be filed when the return is due, including extensions.

The first returns affected by the international boycott provisions, added to the Internal Revenue Code by the Tax Reform Act of 1976, were due February 15, 1977. Taxpayers whose returns were due February 15, or will be due on March 15, or April 15 may use the normal procedures for obtaining an extension of time for filing their income tax returns, and thereby obtain a delay with respect to filing Form 5713.

Alternatively, taxpayers may file their tax returns without attaching Form 5713. However, when the Form 5713 becomes available, those taxpayers must file both copies of Form 5713 no later than June 15, 1977.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: J.C. Davenport
Extension: 2951
February 17, 1977

FOR IMMEDIATE RELEASE

TREASURY ANNOUNCES FINAL DETERMINATION OF NO SALES AT LESS THAN FAIR VALUE WITH RESPECT TO MONOSODIUM GLUTAMATE (MSG) FROM THE REPUBLIC OF KOREA

Acting Assistant Secretary John H. Harper announced today a determination that monosodium glutamate (MSG) from the Republic of Korea is not being, nor is likely to be, sold at less than fair value within the meaning of the Antidumping Act, 1921, as amended. Notice of this decision will appear in the Federal Register of February 18, 1977.

A "Notice of Tentative Determination of Sales At Not Less Than Fair Value" in this matter, published in the Federal Register of November 17, 1976, stated that there was reasonable grounds to believe that the exporter's sales price of MSG from the Republic of Korea, is not less, nor likely to be less, than the fair value of such or similar merchandise. Pursuant to that notice interested persons were afforded the opportunity to present oral and written views prior to the final determination in this case. The Customs Service made price comparisons on MSG sold by one Korean company accounting for 70 percent of the MSG exported to the United States from the Republic of Korea during the period investigated, January - June 1976, and found no margins.

Imports of MSG from the Republic of Korea amounted to approximately 2.7 million pounds, valued at roughly $1.4 million, during the first six months of 1977.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

February 17, 1977

RESULTS OF AUCTION OF 2-YEAR TREASURY NOTES

The Treasury has accepted $2,504 million of $6,461 million of tenders received from the public for the 2-year notes, Series M-1979, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	5.95%
Highest yield	5.99%
Average yield	5.98%

The interest rate on the notes will be 5-7/8%. At the 5-7/8% rate, the above yields result in the following prices:

Low-yield price	99.861
High-yield price	99.786
Average-yield price	99.805

The $2,504 million of accepted tenders includes $ 433 million of noncompetitive tenders and $1,921 million of competitive tenders (including 15% of the amount of notes bid for at the high yield) from private investors. It also includes $ 150 million of tenders at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities in exchange for maturing securities.

In addition, $325 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for securities maturing February 28, 1977, ($150 million) and from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash ($ 175 million).

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Media Contact: Robert E. Nipp
566-5328

FOR IMMEDIATE RELEASE

February 16, 1977

TREASURY SECRETARY BLUMENTHAL APPROVES SECOND LIMITED JONES ACT WAIVER FOR PARGAS, INC. OF WALDORF, MD.

Secretary of the Treasury W. Michael Blumenthal today notified Pargas, Inc. of Waldorf, Maryland, that he has granted a limited waiver of the Jones Act to permit that firm to utilize a foreign vessel on a second voyage to transport liquefied propane gas from Houston, Texas, to the Bayway Refinery, Linden, New Jersey.

Secretary Blumenthal previously had granted a waiver on February 7, for the SINE MAERSK of Danish registry to make the first voyage, reserving permission for a requested second voyage until it could be ascertained that no U.S.-flag LPG carrier technically capable of carrying this cargo was immediately available.

The text of the Secretary's decision telegraphic message is attached.

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B-56

ELEGRAPHIC MESSAGE

NAME OF AGENCY	PRECEDENCE	SECURITY CLASSIFICATION
DEPARTMENT OF THE TREASURY	ACTION: INFO:	UNCLASSIFIED
ACCOUNTING CLASSIFICATION	DATE PREPARED 2/16/77	TYPE OF MESSAGE ☐ SINGLE ☐ BOOK ☐ MULTIPLE-ADDRESS
FOR INFORMATION CALL		
NAME John H. Harper Acting Asst. Secretary (EOTA) WTH	PHONE NUMBER 202-566-5115	

THIS SPACE FOR USE OF COMMUNICATION UNIT

04865

MESSAGE TO BE TRANSMITTED *(Use double spacing and all capital letters)*

TO: Donahue and Donahue
Attorneys at Law
26 Broadway
New York, NY 10004

FEB 16 1977

THIS RESPONDS TO YOUR TELEGRAM OF FEBRUARY 14, 1977,.REQUESTING AN EXTENSION OF A TEMPORARY WAIVER OF THE COASTWISE SHIPPING PROHIBITION IN THE JONES ACT (46 U.S.C. 883) ON BEHALF OF PARGAS, INC., GRANTED IN OUR DECISION LETTER OF FEBRUARY 7, 1977, TO PERMIT THE USE OF THE SS SINE MAERSK FOR A SECOND VOYAGE FOR THE TRANSPORT OF LIQUEFIED PROPANE GAS FROM HOUSTON, TEXAS, TO LINDEN, NEW JERSEY.

WE HAVE BEEN ADVISED BY THE FEDERAL ENERGY ADMINISTRATION AND THE DEPARTMENT OF DEFENSE THAT THE CIRCUMSTANCES RELATING TO THE CURRENT GAS SHORTAGE REMAIN UNCHANGED. THE DEPARTMENT OF COMMERCE HAS ADVISED THAT NO LIQUID PROPANE GAS CARRIER IN THE U.S. FLEET IS AVAILABLE FOR THE TRANSPORTATION OF LPG FROM HOUSTON, TEXAS, TO LINDEN, NEW JERSEY.

THEREFORE, AN EXTENSION OF THE WAIVER ON THE CONDITIONS OUTLINED BELOW IS PRESENTLY NECESSARY IN THE INTEREST OF NATIONAL DEFENSE. THE RESTRICTIONS AGAINST ENGAGING IN THE COASTWISE TRADE IMPOSED ON THE SS SINE MAERSK ARE WAIVED FOR A PERIOD OF 20 DAYS FROM THIS DATE SUBJECT TO THE FOLLOWING CONDITIONS:

FEB 16 5 PM '77

PAGE NO.	NO. OF PGS.	SECURITY CLASSIFICATION
1	2	

1. THE VESSEL WILL BE USED FOR TRANSPORTING LIQUEFIED PROPANE GAS, IN THE AMOUNT OF APPROXIMATELY 7,000 METRIC TONS PER VOYAGE, FROM HOUSTON, TEXAS, TO THE BAYWAY REFINERY AT LINDEN, NEW JERSEY.

2. THE VESSEL WILL ENGAGE IN NO MORE THAN ONE VOYAGE FOR THIS PURPOSE PURSUANT TO THIS EXTENSION.

APPROPRIATE U.S. CUSTOMS SERVICE OFFICIALS HAVE BEEN NOTIFIED OF THIS WAIVER.

SINCERELY,

W. Michael Blumenthal

W. MICHAEL BLUMENTHAL

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

Contact: L.F. Potts
Extension: 2951
February 17, 1977

FOR IMMEDIATE RELEASE

TREASURY DEPARTMENT ANNOUNCES WITHHOLDING OF APPRAISEMENT ON PRESSURE SENSITIVE PLASTIC TAPE FROM ITALY

Acting Assistant Secretary of the Treasury John H. Harper announced today a six-month withholding of appraisement, excluding therefrom Plasturopa SIPA S.a.S., with respect to pressure sensitive plastic tape from Italy, 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. The "pressure sensitive plastic tape" subject to this action is utilized in the sealing of modern shipping cartons or corrugated boxes, and includes pressure sensitive plastic tapes over 1 3/8 inches in width and 4 mils or less in thickness. Notice of this action will appear in the Federal Register of February 18, 1977.

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 18, 1977. 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.

(over)

Imports of the subject merchandise from Italy during the period December 1975 through June 1976 were valued at approximately $2,150,000.

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Department of the TREASURY NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

February 18, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,601 million of 13-week Treasury bills and for $3,601 million of 26-week Treasury bills, both series to be issued on February 24, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing May 26, 1977			26-week bills maturing August 25, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.826	4.644%	4.76%	97.543 a/	4.860%	5.05%
Low	98.817	4.680%	4.80%	97.532	4.882%	5.07%
Average	98.820	4.668%	4.79%	97.537	4.872%	5.06%

a/ Excepting 3 tenders totaling $4,000,000

Tenders at the low price for the 13-week bills were allotted 70%.
Tenders at the low price for the 26-week bills were allotted 7%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 22,570,000	$ 17,070,000	$ 24,770,000	$ 9,770,000
New York	3,914,275,000	2,138,475,000	6,139,825,000	3,165,355,000
Philadelphia	18,560,000	18,560,000	105,165,000	55,165,000
Cleveland	21,935,000	21,935,000	168,805,000	68,805,000
Richmond	33,810,000	27,620,000	60,695,000	33,220,000
Atlanta	33,430,000	31,430,000	23,430,000	21,215,000
Chicago	262,210,000	107,635,000	465,090,000	45,675,000
St. Louis	38,295,000	29,395,000	29,515,000	14,085,000
Minneapolis	52,670,000	46,470,000	70,830,000	33,460,000
Kansas City	34,295,000	34,295,000	19,525,000	14,525,000
Dallas	33,885,000	29,585,000	27,290,000	17,360,000
San Francisco	195,815,000	98,315,000	416,820,000	122,520,000
Treasury	60,000	60,000	---	---
TOTALS	$4,661,810,000	$2,600,845,000 b/	$7,551,760,000	$3,601,155,000 c/

Includes $293,625,000 noncompetitive tenders from the public.
Includes $125,865,000 noncompetitive tenders from the public.
Equivalent coupon-issue yield.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

STATEMENT OF THE HONORABLE LAURENCE N. WOODWORTH
ASSISTANT SECRETARY OF THE TREASURY (TAX POLICY)
ON
THE PRESIDENT'S ECONOMIC STIMULUS PROGRAM
BEFORE THE SENATE SELECT COMMITTEE ON
SMALL BUSINESS
WASHINGTON, D.C., TUESDAY, FEBRUARY 22, 1977, 10:00 A.M.

Mr. Chairman and Members of this Committee:

It is an honor to make my first appearance before this distinguished Committee. I want to discuss with you the employment credit proposed by President Carter. It is an integral element of his special two-year economic stimulus program. I also want to comment on the so-called incremental credit approved by the House Ways and Means Committee.

Overview of the President's Program

The prime objective of the President's program is to accelerate economic recovery toward full utilization of our human and physical resources without rekindling inflationary fires. To promote private sector spending, the Administration has proposed $50 tax rebates and direct payments to virtually the entire U.S. population, an increase in the standard deduction allowed under present tax law, and the option of either a 4 percent credit against the employer's portion of Social Security payroll taxes or an increase of two percentage points in the investment tax credit. The payroll tax credit is aimed toward labor intensive employers because these businesses utilize little capital and hence would benefit little from an increase in the investment tax credit. Because many small businesses are labor intensive, it also is aimed at small businesses generally. The payroll credit would be refundable to the extent it exceeds the employer's current tax liability.

To provide further employment opportunities, the President has proposed an increased authorization of $4 billion for local public works to be spent over two years; an increase of $1 billion in annual expenditures for public service and youth jobs programs and for training; and an expanded countercyclical revenue sharing program which would involve increased outlays of about $700 million in fiscal years 1977 and 1978. This entire package excepting the change in the standard deduction and the business tax cuts has a time horizon of about two years, which is appropriate for a short-term stimulus program. Long-term structural changes will evolve in the months ahead as programs for reform of the tax, health, manpower and welfare systems are presented to Congress.

The economics of the President's program are not complicated. The increased spending generated by both the tax reductions and the expenditure programs will stimulate private and public sector employment, and so long as there is considerable underemployment of labor and plant capacity, the higher levels of employment can be accomplished without serious risk of accelerating the rate of inflation. The public works and job training elements of the program accomplish the stimulus directly; but such programs take time to get underway and, moreover, concentrate their impact in limited areas.

The $50 rebate is quick acting and substantial during the initial period when expenditure programs are not yet fully underway; the standard deduction increase will inject a smaller but welcome increase in take-home pay that will be sustained throughout the stimulus period, as well as providing a start on tax simplification and reform. These tax reductions, plus those immediately provided by the optional employment-investment credit, disperse their effects throughout the economy along the same channels through which tax revenues are withdrawn from the private sector. This assures an earlier and therefore more balanced increase in output and employment then could be achieved with expenditure programs alone.

Incremental Employment Credits

The employment credit proposed by the President has been criticized because it applies to the entire payroll of a business not just to the increase in either employment or payroll. The theoretical superiority of "incremental" over comprehensive employment subsidies is generally recognized by laymen and economists.

Why, then, has the Administration not proposed an "incremental" employment subsidy in place of its comprehensive 4 percent of payroll tax credit? The answer is simple. We have been unable to devise an objective and readily administrable procedure for identifying employment decisions which would not have been made in the absence of the credit. Any feasible method for "incrementalizing" the employment subsidy must use a historic base, and this invariably excludes large and worthy segments of the labor market while at the same time conferring a substantial proportion of the subsidy on "increased" employment that would have taken place in any event.

The situation of particular firms in any phase of the business cycle varies tremendously; they do not march in lock-step up and down recoveries and recessions. Some firms are in industries which are declining and are chronically subject to pressures that keep them below the average year-to-year employment change experienced by the economy as a whole; the railroads, textiles, and shoe manufacturers might be cited as examples. Some firms are in industries which are cyclically sensitive, experiencing above average employment gains during upswings and far more than average declines in periods of recession; machinery and vehicle manufacture and other durable goods might be cited as examples. Moreover, within industries, the fortune of particular firms is variable; in the fifties, American Motors experienced far more favorable employment growth than other auto companies; recently, their fortunes were reversed. Now the largest firms in the industry seem to be experiencing the largest increases.

The one statement that can be made with certainty about a threshold which refers to a prior year and incorporates some notion of "average" change is that such a threshold factually describes the situation of virtually no employer. About half the employers in a given year will be below the threshold in the normal course of events, and about half will be above; the former will be excluded from the credit and thus excluded from responding to the subsidy; the latter will earn a subsidy whether they respond or not. In effect, the threshold serves not to identify incremental decisions but, rather, to omit some employers and favor others.

Also, "incremental" formulations based on each prior year's level of employment invariably increase uncertainty among employers as to their future eligibility for the credit since prior year employment must continually be exceeded to maintain eligibility. This uncertainty inevitably reduces the stimulative effect of the credit.

Finally, and perhaps most important of all, the main obstacle to the employment of additional workers, in the short-run particularly, is the lack of effective demand for the goods and services which would be produced by additional employment. The immediate need, therefore, is to expand market opportunities on the demand side rather than to lower the costs of labor on the supply side. While lowering the costs of labor may have a longer-run defensibility, it is more important for the immediate term to get a quick ejection of spending into the national economy.

In sum, after weighing the unfairness and inefficiency of incremental employment credits against their limited benefits, the Administration concluded that "incremental" formulations of the employment-investment credit option in practice were undesirable and we urge Congress to reject them.

The Employment Credit Approved by the House Ways and Means Committee

I would like to devote the remainder of my remarks to a review of the employment credit the Ways and Means Committee has approved.

In the first instance, the Committee decided to restrict the employment credit to employers who increase their employment by more than 3 percent over the level of the prior year. For this purpose, employment would be measured by wages paid to workers and covered by the Federal Unemployment Tax Act (FUTA). Since the unemployment tax is levied on only the first $4,200 of wages paid, the FUTA base serves as a proxy for numbers of employees. Setting the threshold for eligibility at 103 percent of last year's FUTA base, therefore, appears to be aimed at incorporating a "normal" growth assumption into each employer's determination of eligibility. Only if an employer succeeds in achieving more than a "normal" growth of employment is his increase in employment considered responsive to the credit and hence worthy of subsidy. Also in an attempt to deny the credit to employers who substitute part-time for existing full-time workers, total wages paid must increase by more than 3 percent. This procedure of using the FUTA tax base is far simpler than trying to correct all part-time employment to an annual full-time equivalent base, and the Ways and Means Committee is to be congratulated in formulating this ingenious device.

There are, however, serious problems with any type of incremental base. To show this we have tried to quantify the effect of the threshold proposed by the Ways and Means Committee. For this purpose, we have relied on employment change data for 118 different industry groupings maintained by the Bureau of Labor Statistics. We first estimated the fraction of total employment accounted for by industries that experienced different percentage changes in employment in 1962-63 and 1972-73, periods that are comparably situated with respect to the prior trough in economic activity as 1976-77 is expected to be. Based on this statistical evidence, we estimate that 30 percent of the labor market would be excluded if the threshold in the Ways and Means Committee bill were to be imposed in 1977.

The Ways and Means Committee proposes to further "target" the subsidy by limiting the amount of tax credit to $40,000 per employer. Since the nominal rate of credit proposed is 40 percent of the increase in an employer's FUTA base over the threshold, a maximum of $1,680 per additional employee, this "caps" the eligible additional employees at 24. (For disabled and handicapped workers there is an additional 10 percent credit. The extra credit is not limited by the $40,000 cap.) Thus, employers who in the absence of the credit would increase employment by more than 24 workers, are effectively precluded from responding to the credit by further increasing their employment. These employers have no incentive to add more workers since they would get the full $40,000 maximum benefit without changing their hiring decisions.

Based on the distribution of employers by the rate of growth of employment and by the number of workers employed, we estimate that the $40,000 cap effectively excludes at least 36 percent of the labor market from any possible gains in employment in response to the credit. This labor market is heavily concentrated in industries which require large-scale operations and which show the most growth in recovery from recession. Examples are automobiles, steel, machine tools, electrical equipment manufacturing, and other heavy manufacturing.

An analysis of the effects of these restrictions on the credit suggest curious results. We are proferred an employment subsidy aimed toward increasing jobs, but the very terms of the credit exclude at least 66 percent of the labor market from participating, either because the employer's normal experience places them below the threshold or over the "cap." The restrictions on the credit are thus self-defeating in terms of the objectives of the proposal. Beyond that, they appear unfair to workers in the excluded markets. Finally, as noted below, these restrictions provide incentives toward a distortion of the economic structure among employers that can respond to the subsidy. These employers account for the remaining 34 percent of the labor force.

There are three additional effects of the Ways and Means credit which appear undesirable. The first derives from the fact that the FUTA base is only a proxy for increased employment. As a consequence, a firm intending to hire one additional full-time worker at $10,000 per year can double its credit (assuming it has not reached the $40,000 limit) if it hires two part-time workers at $5,000 each. Thus, the Ways and Means credit is an inducement to hiring new part-time workers.

The wage bill limitation presumably is aimed at denying the credit to employers who substitute part-time workers for existing full-time workers. Given some growth in money wages, currently on the order of 6 to 7 percent per year, the total wage bill limitation will be large ineffective against the replacement of current full-time with part-time workers. Take the case of a firm with 20 workers each earning $10,000 last year. This firm decides to replace one full-time worker with two part-time workers earning $5,350 each this year ($5,000 plus 7 percent). In this case, the total wage bill limitation will not be binding. Assuming a 7 percent increase in wages, total payroll will increase by $14,000, which fully accommodates the $4,200 increase in the FUTA base. This result occurs even though there has been no increase at all in total work hours used by the firm. This "spreading of the work" to qualify for additional amounts of credit greatly increases the revenue cost for any given actual employment stimulus as measured by hours of work.

To be sure, there are extra costs associated with substituting part-time for full-time workers. Payroll taxes, recordkeeping, training, and supervision costs would be increased. But with a tax subsidy of up to 40 percent of wages, the possibility of this type of substitution becomes highly probable. Employement in wholesale and retail trade and in the nontechnical occupations commonly found in the services sector is admirably suited to part-time workers inasmuch as technical skills are not required and flexible work-times are easily scheduled. At the same time, these industries are predominately comprised of small firms and display a relatively stable employment growth at about the average rate for the economy. Hence, they are least likely to be subject to the threshold and "cap" of the employment credit. One consequence of this provision, therefore, is the likely filling of more new openings in stores, warehouses, restaurants, garages and the like with part-time workers, rather than full-time workers. Many of these part-time workers will be second and third earners in families while those displaced are more likely to be family breadwinners.

The second distorting effect of the credit relates to overtime employment. A firm that decides to reduce overtime and hire additional workers may be excluded from the credit because of the wage bill limitation. This results from the fact that overtime work is paid at higher rates than straight time work. Hence, replacing overtime work with new employees could reduce the total wage bill, thereby bringing the overall wage limitation into play. Thus, the credit is a disincentive to the one kind of spreading of work that may be desirable; that is, providing additional jobs <u>after</u> some workers have already worked a full week.

A third distortion is that it would even be possible for noncorporate employers in tax brackets exceeding 50 percent to make money from this program simply by hiring new workers and telling them to stay at home. For example, for an employer subject to the 70 percent marginal tax rate bracket, the tax savings from paying a new employee wages up to the FUTA base of $4,200 actually exceeds the gross amount of wages paid. The tax deduction for wages paid reduces the after-tax labor cost to 30¢ on each dollar. Then, the credit provides an additional tax savings of 40¢ -- or 50¢ where handicapped persons are hired -- for a net wage cost of <u>minus</u> 10¢ or 20¢. Thus, by paying a dollar of wages qualified for the credit, after-tax income of employers can increase by 10¢ or 20¢ even if the new employee is totally unproductive.

The essential point of this illustration is that the rate of this tax subsidy is so large and varies so much among employers that workers may be hired without regard to their prospective productivity or suitability to the job. The opportunity afforded wealthy employers to shelter their personal incomes from tax without providing meaningful new jobs is likely to be widely regarded as unfair. In fact, it would obviously be cheaper for the government to pay $4,200 directly to each worker than to pay 110 or 120 percent of this amount -- up to $5,040 -- just to say that a private sector "job" has been created.

This is admittedly an extreme result, but it illustrates an important general consideration of economic efficiency frequently neglected in discussions of subsidies. Whenever the tax system is used to reduce private costs, this encourages more profligate use of resources. In periods of unemployment, the cost to society in foregone alternative uses of resources may be low or even zero, and some employment subsidy may be justified. But the subsidy should not be so large as to encourage private citizens to use resources as if they cost less than nothing.

Any additional jobs attributable to the credit would be confined to industries and regions that would otherwise have experienced employment growth, and they would be confined primarily to small and medium sized businesses. This means that trade and construction workers would benefit as compared to those in manufacturing, and there would be some acceleration of the movement of jobs to those regions that have been growing more rapidly, especially the South and West, as compared to those places where employment growth has been slower or employment has been declining. The types of jobs that receive the most subsidy are those requiring limited skills and at relatively low pay. Because this program would provide a large subsidy for each additional employee, but for only the year in which he is hired, many of these additional jobs may also be temporary.

I will conclude my remarks this morning by responding directly to the question addressed to me by Senator Haskell in his letter of invitation. He asked whether there is "any conflict in maximizing the employment aspects and the benefits for small and medium-sized businesses" in the design of an employment credit. I believe that my earlier observations on the effects of the $40,000 cap in the Ways and Means Committee proposal have suggested there is conflict in these two objectives. If an employment subsidy is offered which excludes the employment potential provided by enterprises with 500 or more workers, this cuts out of any employment-increasing program about 45 percent of all job opportunities. This would be to fight the short-run battle agains unemployment with only half the troops available.

If we should adopt national policies to encouraging employment in enterprises below some fixed number of workers, this will only serve to distort economic relationships. I would, strongly advise against trying to achieve reductions in national unemployment rates in a measure which also tries to stimulate the growth of small and medium-size enterprises. Rather I would urge both these objectives be sought by appropriate means. The President's program is directed toward full-employment. Stimulus to the rigor and growth of small businesses should be approached by policies to remove barriers, whatever their source, as they are identified.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. February 22, 1977

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 million, or thereabouts, to be issued March 3, 1977, as follows:

91-day bills (to maturity date) in the amount of $2,500 million, or thereabouts, representing an additional amount of bills dated December 2, 1976, and to mature June 2, 1977 (CUSIP No. 912793 G5 9), originally issued in the amount of $3,506 million, the additional and original bills to be freely interchangeable.

182-day bills, for $3,600 million, or thereabouts, to be dated March 3, 1977, and to mature September 1, 1977 (CUSIP No. 912793 J8 0).

The bills will be issued for cash and in exchange for Treasury bills maturing March 3, 1977, outstanding in the amount of $6,110 million, of which Government accounts and Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $2,954 million. 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 and from individuals at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, February 28, 1977. 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 positio 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 or at the Bureau of the Public Del on March 3, 1977, in cash or other immediately available funds or in a like face amount of Treasury bills maturing March 3, 1977. Cash and exchange tenders will receive equal treatment. Cash adjustments will be made for differen 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 accr 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 Federa income tax return, as ordinary gain or loss, the difference between the price pai for the bills, whether on original issue or on subsequent purchase, and the amoun 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 noti prescribe the terms of the Treasury bills and govern the conditions of their issu Copies of the circular may be obtained from any Federal Reserve Bank or Branch, c from the Bureau of the Public Debt.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 23, 1977

RESULTS OF AUCTION OF 4-YEAR 1-MONTH TREASURY NOTES

The Treasury has accepted $2,250 million of $4,511 million of tenders received from the public for the 4-year 1-month notes, Series H-1981, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	6.85% 1/
Highest yield	6.90%
Average yield	6.88%

The interest rate on the notes will be 6-7/8%. At the 6-7/8% rate, the above yields result in the following prices:

Low-yield price	100.073
High-yield price	99.898
Average-yield price	99.968

The $2,250 million of accepted tenders includes $352 million of noncompetitive tenders and $1,898 million of competitive tenders (including 40% of the amount of notes bid for at the high yield) from private investors.

In addition, $550 million of tenders were accepted at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities for new cash.

1/ Excepting 4 tenders totaling $2,220,000

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

STATEMENT OF LAURENCE N. WOODWORTH
ASSISTANT SECRETARY (TAX POLICY)
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS
FEBRUARY 24, 1977 10:00A.M.

Mr. Chairman and Members of the Subcommittee on Oversight:

I am pleased to appear before you today to discuss two administrative provisions contained in the Tax Reform Act of 1976. These provisions are: Section 1202 of that Act (now section 6103 of the Internal Revenue Code) relating to "confidentiality and disclosure of returns and return information" and section 1205 of that Act (now section 7609 of the Internal Revenue Code) concerning "special procedures for third-party summonses."

My purpose in testifying today is not to address in detail the administrative problems resolved or created by these Tax Reform provisions; information in that regard will be furnished by other Administration witnesses who are more directly involved with the operation of these provisions. Rather, my remarks will focus on the principles of tax policy that underlie the recent administrative amendments. It is my hope that these tax policy principles will remain within the view of this Subcommittee as it reexamines sections 1202 and 1205 of the Tax Reform Act.

Disclosure of Returns and Return Information

Prior to the enactment of the Tax Reform Act of 1976, procedures for disclosure of tax information had developed in a piecemeal manner. For a period of more than 40 years, various statutes, regulations, and executive orders were promulgated without sufficient consideration of a comprehensive approach to return disclosure. Consequently, pre-

1977 law reflected only a vague disclosure policy and contained few meaningful restrictions on a government official's access to tax returns and return information.

As the tax laws have become increasingly complex, there has been a corresponding increase in the amount of personal and financial data on tax returns. And predictably, returns have become an attractive source of information for scores of government agencies. Under the pre-1977 procedures, tax returns were routinely made available to such diverse organizations as the Department of Defense, the Federal Trade Commission, the Department of the Interior, the Tennessee Valley Authority, and the Veterans' Administration.

In recognition of the pervasive impact of the tax laws in today's society and the substantial harm that can result from improper use of tax information, Congress determined in the Tax Reform Act of 1976 to provide more stringent limitations upon the disclosure of such information. Section 1202 of the Act provides new standards for disclosure in the case of several categories of potential recipients of tax data, including congressional committees, State tax officials, Federal agencies, and the President and his White House staff.

For example, under prior law, a Justice Department official had access to tax information if it was deemed to be "necessary in the performance of his official duties." This standard has been replaced by a rule that permits varying degrees of access depending in part upon the nature of the case involved, the taxpayer's relationship to the case being investigaged or tried, and the relevance of return information to issues involved in the proceeding. The Act would generally deny access to tax data in non-tax civil cases and would demand a court order before disclosure of taxpayer return information in non-tax criminal cases. Disclosure in tax cases would generally be governed by the rules under prior law, except that tax return information with respect to a third party would generally be made available only upon the showing of a more direct relationship between the information and the issues involved in the tax proceeding.

The Department of Justice has raised a number of concerns with the operation of these new standards in section 1202 of the Act. We agree with the Justice Department that steps should be taken to ensure, either by regulation or, if necessary, by statutory amendment, that neither civil nor criminal penalties will be imposed unless unlawful disclosure is wilful or negligent. Other technical problems raised by the new provisions may require amendments in the event these problems cannot be resolved satisfactorily by means of regulations. However, we do not believe such problems warrant a postponement of section 1202's effective date. The Treasury Department would be pleased to work with the Justice Department and with the Congress in correcting any such technical problems. Our objective will be to ensure that a proper balance is struck between the taxpayer's right to privacy and the Government's responsibility to enforce the law.

Third-Party Summonses

In the past, the Internal Revenue Service has had the authority during the course of an investigation to determine tax liability, to issue a summons to third-parties in order to examine any records "relating to the business of the person liable for tax." Heretofore, there has been no requirement that the taxpayer be given notice that a third-party summons has been served. As a result, the government is able to obtain detailed records of a taxpayer's banking accounts and other financial data without the taxpayer's awareness that he is being investigated.

Congress, in enacting section 1205 of the Tax Reform Act, decided that a change in the procedure for issuing administrative summonses was desirable in order to protect the civil rights and the privacy of taxpayers. The Act requires that a taxpayer receive notice with respect to third-party summonses issued to banks, brokers, accountants and certain other recordkeepers after February 28, 1977. This notice must be given to the taxpayer within 3 days after the summons is served. Then the taxpayer has a period of 14 days in which he can inform the third-party not to comply with the summons. The Act also gives the taxpayer the right to intervene in any subsequent action commenced by the government to enforce the summons.

As in the case of the disclosure provisions, the administrative summons rules should reflect a careful balance between the civil rights of an individual and the need of the government to enforce the laws. The Treasury Department believes that an individual's right of privacy deserves, at least, that he be provided with notice that a third-party recordkeeper has been summoned to provide documents. However, we recognize that the new summons procedures apparently would impose substantial burdens on the tax collectors and the courts. Accordingly, we recommend that the effective date of section 1205 be deferred until no later than September 1, 1977 in order to provide time for the Treasury, the IRS and the Justice Department to cooperate with Congress in considering a modified procedure for taxpayer intervention in summons procedures.

Two possible changes that appear to be worthy of careful examination would: (1) limit the taxpayer's rights to notice and intervention to the first summons and (2) relieve a third party recordkeeper from liability to the taxpayer for responding to the summons. Perhaps in this way, a taxpayer's rights can be protected while, at the same time, the burdens on the recordkeeper and the government can be minimized.

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

FOR IMMEDIATE RELEASE
FRIDAY, FEBRUARY 25, 1977
CONTACT: PRISCILLA CRANE (202) 634-5248

REVENUE SHARING ANNUAL REPORT RELEASED

The Annual Report of the Department of the Treasury's Office of Revenue Sharing, covering Federal fiscal year 1976 and the transition quarter, was released today.

Revenue sharing law requires that an annual report of the status of the revenue sharing trust fund be made to the Congress.

"In addition, our Annual Report describes improvements which have been made in the administration of the General Revenue Sharing Program during the past year," Miss Jeanna D. Tully, Director of the Office of Revenue Sharing stated in announcing the publicaton.

Individual copies of the Annual Report are available from the Office of Revenue Sharing at 2401 E Street, N.W., Washington, D.C., 20226.

Since the General Revenue Sharing Program first was authorized, in 1972, approximately $30 billion has been returned to 39,000 States, counties, cities, townships, Indian tribes and Alaskan native villages. In 1976, the program was extended for three and three-quarters years past December 31, 1976. The amount to be distributed during the renewal period will be $25.6 billion.

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Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. February 24, 1977

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for $3,105 million, or thereabouts, of 364-day Treasury bills to be dated March 8, 1977, and to mature March 7, 1978 (CUSIP No. 912793 M4 5). The bills, with a limited exception, will be available in book-entry form only, and will be issued for cash and in exchange for Treasury bills maturing March 8, 1977.

This issue will not provide new money for the Treasury as the maturing issue is outstanding in the amount of $3,105 million, of which $1,904 million is held by the public and $1,201 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 par amount will be payable without interest. Except for definitive bills in the $100,000 denomination, which will be available only to investors who are able to show that they are required by law or regulation to hold securities in physical form, this series of bills will be issued entirely in book-entry form on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Wednesday, March 2, 1977. Form PD 4632-1 should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

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.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities, for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches, or for definitive bills, where authorized. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

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 for bills to be maintained on the records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on March 8, 1977, in cash or other immediately available funds or in Treasury bills maturing March 8, 1977. 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 a 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 Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

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

Contact: Robert E. Nipp
566-5328

FOR IMMEDIATE RELEASE, FEBRUARY 28, 1977

TREASURY SECRETARY BLUMENTHAL DISAPPROVES LIMITED JONES ACT WAIVER REQUESTED BY TEN EAST COAST FIRMS

Secretary of the Treasury W. Michael Blumenthal has notified a group of ten East Coast firms that he has denied their request for a limited waiver of the Jones Act to permit use of three foreign vessels to transport liquefied propane gas (LPG) from Houston, Texas, to U.S. East Coast terminals at Newington, New Hampshire; Providence, Rhode Island; Bayway, New Jersey; and Philadelphia, Pennsylvania. The request was made on behalf of National Fuel Gas Distribution Corporation, Buffalo, NY; Philadelphia Gas Works, Philadelphia, PA; Providence Gas Company, Providence, RI; Valley Gas Company, Cumberland, RI; Northern Utilities, Inc., Portland, Maine; Gas Service, Inc., Nashua, NH; C.M. Dining, Inc., Exeter, NH; Northeast Utilities, Berlin, CT; Fall River Gas, Fall River, MA; Berkshire Gas Company, Pittsfield, MA.

In denying the waiver, Secretary Blumenthal stated that he was unable to establish that the propane to be transported was presently necessary in the interest of national defense.

The ten firms had requested a waiver of the coastwise laws, commonly called the Jones Act (46 U.S.C. 883), to permit the use of three Norwegian-flag vessels, FERNBANK, BARFONN, AND MONDOGAS ATLANTIC, with combined cargo capacity of 29,000 metric tons, to transport some 21 million gallons of propane to their outlets in New York, Pennsylvania, Rhode Island, Maine, New Hampshire, Massachusetts, and Connecticut.

The text of the Secretary's decision letter is attached.

# # #

B-65

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

FEB 25 1977

Dear Mr. Connole:

This responds to your letters of February 7 and 9, 1977, requesting a temporary waiver of the coastwise shipping prohibition in the Jones Act (46 U.S.C. 883) on behalf of 10 companies to permit the use of three foreign vessels for the transport of liquefied propane gas (LPG) from Houston, Texas, to East Coast terminals.

The Federal Energy Administration (FEA) has advised me that the lack of adequate supplies of gas results directly in a high level of industrial curtailment when unusually cold weather requires a heavy diversion of gas from industrial and large commercial users to residential users. FEA also noted that, because the need to fill severely depleted reserves would result in continued industrial load curtailments, additional supplies of propane would result in a reduction of such curtailments.

The Department of Commerce has advised me that an LPG carrier in the U.S. fleet, the PONCIANA, may be available to carry part of this cargo. Furthermore, it opposes a Jones Act waiver in this case unless a determination is made by the Department of Defense that it is in fact in the interest of national defense.

The Department of Defense (DoD) has advised me that, in this case, the relationship of the LPG involved in the waiver application to natural gas shortage impacts upon the operation of key DoD contractors and installations has not been demonstrated. Lacking such a relationship, DoD states that it is unable, in view of its own direct interests, to pass on the merits of the application or to make any recommendations with respect to specifics of the waiver.

I have, therefore, found that I am unable to determine that the waiver you requested is presently necessary in the interest of national defense. Pursuant to the Act of December 27, 1950 (64 Stat. 1120), I have no alternative but to deny your request to waive the restrictions against engaging in the coastwise trade imposed on the FERNBANK, BARFONN, and MUNDOGAS ATLANTIC, all Norwegian-flag vessels, by Section 883 of Title 46 of the United States Code.

Appropriate U.S. Customs Service officials have been notified of this decision.

Sincerely,

W Michael Blumenthal

W. Michael Blumenthal

William R. Connole, Esq.
Connole and O'Connell
One Farragut Square South
Washington, DC 20006

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE February 28, 1977

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,503 million of 13-week Treasury bills and for $3,600 million of 26-week Treasury bills, both series to be issued on March 3, 1977, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing June 2, 1977			26-week bills maturing September 1, 1977		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	98.819	4.672%	4.79%	97.513	4.919%	5.11%
Low	98.809	4.712%	4.83%	97.496	4.953%	5.15%
Average	98.810	4.708%	4.83%	97.501	4.943%	5.14%

Tenders at the low price for the 13-week bills were allotted 99%.
Tenders at the low price for the 26-week bills were allotted 46%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS AND TREASURY:

Location	Received	Accepted	Received	Accepted
Boston	$ 35,935,000	$ 22,790,000	$ 26,430,000	$ 15,430,000
New York	4,005,300,000	2,069,740,000	4,902,345,000	3,036,645,000
Philadelphia	23,930,000	23,930,000	30,750,000	30,750,000
Cleveland	28,695,000	28,695,000	101,395,000	40,995,000
Richmond	47,785,000	25,730,000	37,235,000	22,235,000
Atlanta	60,515,000	48,835,000	11,185,000	11,185,000
Chicago	404,620,000	64,540,000	303,575,000	82,495,000
St. Louis	65,230,000	57,440,000	34,990,000	20,990,000
Minneapolis	43,165,000	19,035,000	56,640,000	45,640,000
Kansas City	39,850,000	35,015,000	19,020,000	19,020,000
Dallas	38,840,000	16,840,000	20,340,000	20,340,000
San Francisco	286,275,000	90,135,000	432,460,000	254,680,000
Treasury	10,000	10,000	10,000	10,000
TOTALS	$5,080,150,000	$2,502,735,000a/	$5,976,375,000	$3,600,415,000 b/

Includes $335,930,000 noncompetitive tenders from the public.
Includes $125,500,000 noncompetitive tenders from the public.
Equivalent coupon-issue yield.

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

FOR IMMEDIATE RELEASE February 28, 1977

STATEMENT BY SECRETARY BLUMENTHAL

I have informed Mayor Beame that I have reservations concerning my authority to approve the $255 million dollar loan requested by New York City under the New York Seasonal Financing Act of 1975.

By statute, I must find that there is a reasonable prospect that the loan will be repaid. My ability to make such a finding depends upon developments within the power of New York's public and private leaders, particularly concerning the current negotiations over financing the payment of the moratorium notes. What is now required on their part is a renewed effort so that this financing can be brought to a status that would permit me to approve this loan.

The City's fiscal situation continues to be a matter of great concern to me, but I am encouraged to note that Mayor Beame is pressing vigorously for a solution.

# # #

B-67

EMBARGOED FOR RELEASE
UNTIL 11:00 AM (EST)

JANUARY 4, 1977

Office of the White House Press Secretary

THE WHITE HOUSE

FACT SHEET

The President's Tax Message

President Ford today proposed in a message to the Congress individual income tax relief of approximately $10 billion and corporate tax rate cuts of $2.5 billion for calendar year 1977. These tax reduction proposals are similar to those initially proposed in October 1975. In addition, the President proposed increases in social security contributions in order to maintain the integrity of the old age and disability trust funds which would otherwise be depleted by the early 1980's.

The President's recommendations also include accelerated depreciation for new plants and equipment built in areas of high unemployment; a tax credit for home insulation; exempting charitable contributions from the burden of minimum taxes; increasing the railroad retirement tax in a manner consistent with the recommended social security tax increases; and providing State and local governments with an option to issue taxable bonds subsidized in part by the Federal Government.

The President renewed his proposal to eliminate gradually the double taxation of dividends paid by corporations.

MAJOR PROVISIONS

Major Proposed Changes in the Personal Income Tax

- Permanently increase the personal exemption from $750 to $1,000 to replace the temporary tax credit of $35 per exemption and the alternative credit of 2 percent of taxable income up to $9,000. Under the 1976 law taxpayers choose the higher of these two credits.

- Raise the low income allowance for single persons from $1,700 to $1,800 and for joint returns from $2,100 to $2,500.

- Lower marginal tax rates as shown in Table 6.

- Eliminate the earned income credit.

  The effects of these changes on individual and family tax burdens are shown in Tables 7, 8, and 9.

more

Major Proposed Changes in Business Taxes

- Reduce the maximum corporate tax rate from 48 to 46 percent.

- Permanently extend the corporate surtax exemption provisions. This would result in a tax rate of 20 percent on the first $25,000 of income and a rate of 22 percent on the second $25,000 of income. These provisions of the Tax Reform Act of 1976 are scheduled to expire at the end of 1977. At that time the first $25,000 of corporate income would be taxed at 22 percent and all income above $25,000 would be taxed at the maximum corporate rate.

- Permanently extend the 10 percent investment tax credit. Under current law the credit reverts to 7 percent at the end of 1980.

- Permit accelerated depreciation for new plant and equipment in labor market areas with unemployment rates of 7 percent or higher. The proposed tax incentive would allow straight line depreciation over a period equal to one-half their useful lives for buildings and would allow five-year amortization with a full investment tax credit for equipment. This incentive would apply to projects which both begin during calendar year 1977 and are completed within 36 months.

- Eliminate the double tax on corporate dividends by means of a deduction at the corporate level for a portion of dividends paid and an adjustment at the shareholder level for the remaining corporate tax on dividend distributions. The proposal contemplates a six-year phase-in of the corporate dividend deduction over the period from 1978 to 1983 and a five-year phase-in of the adjustment at the shareholder level over the period from 1979 to 1983.

- Repeal the provision of current law that allows funding Employee Stock Ownership Plans (ESOPs) through supplemental investment tax credits.

Proposed Changes in Social Security Payroll Taxes

The revenues provided by current payroll tax law are insufficient to finance the current old age, survivors, and disability benefits, and accordingly the trust funds are being depleted. If the tax law remains unchanged, the combined old age and disability trust funds will be exhausted by the early 1980's.

The 1977 Budget Message contained a proposal for a 0.6 percentage point increase, effective January 1, 1977, in the combined rate for employers and employees (0.3 percentage point increase in both the employer and employee share). The total 1977 OASDHI tax rate would then have equalled 12.3 percent.

However, the Congress failed to act on this proposal. For technical reasons, retroactive social security tax increases are not practical so that this year's budget does include an increase for calendar year 1977. Partly because of these delays, a larger tax increase is now required to replenish the trust funds. The President recommended phasing in the tax rate increase over a three-year period.

Specifically, the President proposed the following schedule of combined employer-employee payroll tax increases:

- a 0.2 percentage point increase effective January 1, 1978 in addition to the 0.4 percentage point increase mandated by current law. The self-employment tax would also be adjusted upward.

- a 0.6 percentage point increase effective January 1, 1979.

- a 0.3 percentage point increase effective January 1, 1980.

The effect on tax burdens of the social security tax increases combined with the individual tax reductions is shown in Tables 13 and 14.

<u>Proposals Affecting Charities and Private Foundations</u>

The President proposed excluding all charitable contributions from the base of the minimum tax to remove any possible disincentive to charitable giving. Under the Tax Reform Act of 1976, the base for the minimum tax includes itemized deductions (with the exception of medical expenses and casualty losses) in excess of 60 percent of adjusted gross income.

The President proposed reducing from 4 percent to 2 percent the excise tax private foundations currently pay on their net investment income to cover the cost of auditing foundations. A 2 percent excise tax will produce sufficient revenue to cover these auditing costs.

<u>Taxable Municipal Bond Option and Industrial Development Bond Proposal</u>

The President proposed giving State and local governments the option of issuing taxable securities in return for a Federal subsidy equal to 30 percent of the net interest cost. The President also recommended limiting industrial development bonds and federal guaranteed financing to the taxable market to prevent overloading the municipal market with bonds which essentially depend on private or Federal credit. The President proposed providing a Federal subsidy not exceeding 20 percent of the net interest cost for industrial development bonds shifted from the tax exempt to the taxable market.

Residential Insulation

The President proposed a 15 percent tax credit for the cost of certain improvements in thermal efficiency in owner-occupied homes. This credit would apply to the first $1,000 of expenditures for energy-saving improvements such as insulation and storm windows and could be claimed during the three years following enactment. Total credits claimed by any tax-filing unit during the three-year period would not exceed $150.

R&D Tax Treatment of Certain Geothermal Resource Discovery Costs

The President proposed amending the section of the tax code dealing with research and development expenditures to cover projects which are certified by ERDA to be for the discovery and development of geothermal resources in order to remove the dampening effect of tax uncertainty on the willingness of private investors to participate in the discovery of geothermal resources. The proposal provides that, with respect to any geothermal project certified by ERDA during the next 10 years, all expenditures incurred before achievement of the commercial development stage will be accorded the treatment allowed by tax law for R&D expenditures, that is, such expenditures will be currently deducted or capitalized and amortized within five years.

Highway Trust Fund Taxes

The President proposed extending the Federal highway program and the highway trust fund taxes scheduled to expire in September 1979.

Miscellaneous Revenue Proposals

The President proposed writing off outstanding silver certificates since these Federal Reserve Bank notes and National Bank notes are not expected to be redeemed. The value of the certificates would be recorded as governmental receipts in the year they are written off.

The President proposed collecting inland waterway user charges to help offset the Federal subsidies presently dedicated to this mode of transportation.

The President proposed allowing the Nuclear Regulatory Commission to collect annual fees to cover the costs of its licensing services and its reactor safety research program in support of licensing.

# # # #

TABLES

Table 1

Change in Tax Liabilities
President's Proposals Compared to 1976 Law

(1977 Levels of Income)
($ billions)

Tax Change	President's proposal for calendar year 1977	
Personal Tax Provisions		
Personal Exemption	-11.3	
Standard Deduction	- 0.8	
Rate Reductions	- 8.1	
Repeal of Temporary Credits of Tax Reform Act 1/	+10.4	
Subtotal		- 9.8
Corporate Rate Reductions		- 2.5
Other Tax Provisions		+ 0.2
Total Change in Tax Liabilities		-12.1

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

1/ Excludes outlay portion of Earned Income Credit.

Table 2

Change in Tax Liabilities Under President's Program
Compared to Extension of Tax Reform Act of 1976

($ billions)

	Effective Date	Calendar Years 1977	1978	1979
:oposed Legislation:				
Repeal Tax Reform Act of 1976 (Extended) reductions and replace with President's proposed reductions:	1/1/77			
Individual tax cuts		-9.8	-10.4	-11.0
Corporate tax rate cuts		-2.5	-2.7	-2.9
Total		-12.3	-13.1	-13.9
Social security tax rate increase	1/1/78		2.0	8.2
Social security treatment of tips	1/1/78		.1	.1
Railroad retirement tax rate increase	1/1/78		*	.1
Repeal investment tax credit ESOPs	1/1/77	.2	.3	.3
Accelerated depreciation in high unemployment areas:	1/1/77			
Individuals		*	-.1	-.1
Corporations		-.1	-.3	-.5
Total		-.1	-.4	-.7
Corporation tax integration:	1/1/78			
Individuals				-.6
Corporations			-2.5	-3.7
Total			-2.5	-4.3
Write-off liability on silver certificates.	9/15/77	.2		
Fees for regulatory and judicial services..	1/1/77	*	*	*
Miscellaneous (waterway) fees	1/1/77	.1	.1	.2
Exclude charitable contributions from minimum tax	1/1/77	-.1	-.1	-.1
Reduce administrative fees on foundations..	1/1/77	*	*	*
Taxable municipal bond option 1/...........	1/1/78		*	*
Industrial development bonds 1/...........	1/1/78		*	.1

Table 2 (continued)

($ billions)

	Effective Date	Calendar Years 1977	1978	1979
Home insulation credit	1/1/77	-.2	-.2	-.2
R & D treatment of geothermal discovery costs	7/1/77	*	*	*
Continue Highway Trust Fund at present rates	10/1/79			1.1
tal due to proposed legislation in excess of extension of Tax Reform Act of 1976		-12.1	-13.6	-9.0
anges in receipts from current law due to permanent extensions of temporary tax provisions 2/		____	-13.2	-14.0
tal		-12.1	-26.8	-23.0

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

* Less than $50 million.

1/ Excludes outlay portion of program.

2/ President's program also includes permanent extension of the 10 percent investment tax credit beyond 1980 when it would otherwise revert to 7 percent and permanent extension of the corporate surtax exemption provisions beyond their 12/31/77 expiration date; these latter extensions reduce corporate tax liabilities by $2.3 billion and $2.5 billion in 1978 and 1979 respectively.

Table 3

Total Tax Liability Under Various Tax Laws

(1976 Levels of Income)

($ millions)

Adjusted Gross Income Class	1974 Law	1975 Law	1976 Law	President's Proposed 1977 Law
($000)				
Up to 0	13	12	12	12
0 - 5	2,170	1,304	1,124	864
5 - 10	13,994	11,553	10,422	9,045
10 - 15	23,009	21,296	19,858	17,598
15 - 20	26,653	24,842	23,675	21,601
20 - 30	35,833	34,437	33,485	31,371
30 - 50	23,002	22,580	22,280	21,551
50 - 100	16,620	16,502	16,421	16,087
100 or over	13,180	13,157	13,138	13,050
TOTAL	154,475	145,684	140,414	131,180

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Office of Tax Analysis

December 29, 1976

Note: Estimates exclude outlay effects of the Earned Income Credit.

Table 4

Distribution of Tax Liabilities Under President's Proposals for Individual Tax Cuts for 1977 Compared with 1976 Law by Size of Adjusted Gross Income

(1976 Levels of Income)

Adjusted Gross Income Class	Total Tax Liability		Tax Cut Caused by President's Proposal for 1976		
	President's Proposal	1976 Law 1/	Amount	Percent Distribution	As Percent of Tax Under 1976 Law
($000)	(...........$ billions.........)		(.....................percent......................)		
Up to 5	.9	1.1	0.3	2.8%	23.0%
5 - 10	9.0	10.4	1.4	14.9	13.2
10 - 15	17.6	19.9	2.3	24.5	11.4
15 - 20	21.6	23.7	2.1	22.5	8.9
20 - 30	31.4	33.5	2.1	22.9	6.3
30 - 50	21.6	22.3	0.7	7.9	3.3
50 - 100	16.1	16.4	0.3	3.6	2.0
100 +	13.1	13.1	0.1	1.0	0.7
TOTAL	131.2	140.4	9.2 2/	100.0	6.6

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

1/ Estimates exclude outlay portions of Earned Income Credit; they are treated as expenditures.

2/ Total would equal 9.8 billion at 1977 levels of income.

Table 5

Individual Income Tax Provisions: 1974-1976,
and Proposed for 1977 and Thereafter

Deductions and Credits	1974 law	1975 law	1976 law	President's Proposal for 1977
andard deduction:				
ίinimum: (Low income allowance)				
Joint returns	$1,300	$1,900	$2,100	$2,500
Single and head of household	1,300	1,600	1,700	1,800
Percentage rate:......................	15%	16%	16%	16%
ίaximum:				
Joint returns	$2,000	$2,600	$2,800	$2,800
Single and head of household	2,000	2,300	2,400	2,400
rsonal exemption	$750	$750	$750	$1,000
eral tax credit				
er capita credit	--	$30	$35	--
-or-				
ptional taxable income credit:				
Percentage rate	--	--	2%	--
Maximum	--	--	$180	--
rned income credit:				
Percentage rate	--	10%	10%	--
ίaximum	--	$400	$400	--
Income level where phased out	--	$8,000	$8,000	--

ice of the Secretary of the Treasury
Office of Tax Analysis

December 21, 1976

Table 6

Individual Income Tax Rates: Current Law and President's Proposal

Single Returns			Joint Returns		
Taxable Income Bracket	Current Law Tax Rates	President's Proposed Rates	Taxable Income Bracket	Current Law Tax Rates	President's Proposed Rates
($000)	(............%............)		($000)	(............%..........)	
0 - 0.5	14%	12%	0 - 1	14%	12%
0.5 - 1	15	13	1 - 2	15	14
1 - 1.5	16	15	2 - 3	16	15
1.5 - 2	17	15	3 - 4	17	15
2 - 3	19	16	4 - 6	19	16
3 - 4	19	17	6 - 8	19	17
4 - 5	21	18	8 - 10	22	21
5 - 6	21	19	10 - 12	22	22
6 - 8	24	21	12 - 16	25	25
8 - 10	25	24	16 - 20	28	29*
10 - 12	27	27	20 - 24	32	34*
12 - 14	29	29	24 - 28	36	36
14 - 16	31	31	28 - 32	39	39
16 - 18	34	34	32 - 36	42	42
18 - 20	36	36	36 - 40	45	45
20 - 22	38	38	40 - 44	48	48
22 - 26	40	40	44 - 52	50	50
26 - 32	45	45	52 - 64	53	53
32 - 38	50	50	64 - 76	55	55
38 - 44	55	55	76 - 88	58	58
44 - 50	60	60	88 - 100	60	60
50 - 60	62	62	100 - 120	62	62
60 - 70	64	64	120 - 140	64	64
70 - 80	66	66	140 - 160	66	66
80 - 90	68	68	160 - 180	68	68
90 - 100	69	69	180 - 200	69	69
.00 & over	70	70	200 & over	70	70

' Although two rates are increased in the higher brackets, taxpayers with income taxed in those brackets will benefit from rate reductions in the lower brackets so that on balance the changes in rates reduce taxes even for those affected by the increased marginal rates.

fice of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

Table 7

Tax Liabilities Under Various Tax Laws for Single Person Without Dependents, With Itemized Deduction of 16 Percent of Adjusted Gross Income 1/

Adjusted Gross Income	Tax Liability: 1974 Law	1975 Law	1976 Law	President's Proposed 1977 Law
$ 5,000	$ 490	$ 404	$ 363	$ 307
7,000	889	796	714	641
10,000	1,506	1,476	1,331	1,227
15,000	2,589	2,559	2,409	2,307
20,000	3,847	3,817	3,667	3,553
30,000	6,970	6,940	6,790	6,655
40,000	10,715	10,685	10,535	10,375
50,000 2/	14,915	14,885	14,735	14,575
100,000 2/	35,915	35,885	35,735	35,575

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

1/ If standard deduction exceeds itemized deduction, individual uses standard deduction.

2/ Assumes all income is wage income and that provisions of maximum tax on earned income apply.

Table 8

Tax Liabilities Under Various Tax Laws for Family with No Dependents, Filing Jointly with Itemized Deductions of 16 Percent of Adjusted Gross Income 1/

Adjusted Gross Income	Tax Liability			
	1974 Law	1975 Law	1976 Law	President's Proposed 1977 Law
$ 5,000	$ 322	$ 170	$ 130	$ 60
7,000	658	492	448	335
10,000	1,171	1,054	948	800
15,000	2,062	2,002	1,882	1,750
20,000	3,085	3,025	2,905	2,780
30,000	5,564	5,504	5,384	5,328
40,000	8,702	8,642	8,522	8,444
50,000	12,380	12,320	12,200	12,080
100,000 2/	33,310	33,250	33,130	33,000

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

1/ If standard deduction exceeds itemized deduction, family uses standard deduction.

2/ Assumes all income is wage income and that provisions of maximum tax on earned income apply.

Table 9

Tax Liabilities Under Various Tax Laws for Family with 2 Dependents, Filing Jointly with Itemized Deductions ~~of 16 Percent of Adjusted Gross Income~~ 1/

Adjusted Gross Income	Tax Liability: 1974 Law	1975 Law 3/	1976 Law 3/	President's Proposed 1977 Law
$ 5,000	$ 98	$ 0	$ 0	$ 0
7,000	402	186	135	60
10,000	886	709	651	485
15,000	1,732	1,612	1,552	1,325
20,000	2,710	2,590	2,530	2,280
30,000	5,084	4,964	4,904	4,648
40,000	8,114	7,994	7,934	7,664
50,000	11,690	11,570	11,510	11,180
100,000 2/	32,560	32,440	32,380	32,000

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

1/ If standard deduction exceeds itemized deduction, family uses standard deduction.

2/ Assumes all income is wage income and that provisions of maximum tax on earned income apply.

3/ 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 and if their adjusted gross income is less than $8,000. If the effects of the EIC were included, the table would show these tax liabilities:

AGI	1975 Law	1976 Law	President's 1977 Proposa
$3,000	$ -300	$ -300	$ 0
5,000	-300	-300	0
7,000	86	35	60

Table 10

Projected Poverty Levels Compared to Tax-Free Income Levels 1/

	1975		1976		1977	
	Poverty Level	Tax-Free Income	Poverty Level	Tax-Free Income	Poverty Level	Tax-Free Income President's Proposal
Single Person	$2,800	$2,560	$2,960	$2,700	$3,110	$2,800
Married couple:						
No Dependents	3,620	3,830	3,820	4,100	4,020	4,500
2 Dependents	5,500	5,760 2/	5,820	6,100 2/	6,110	6,500

Office of the Secretary of the Treasury
Office of Tax Analysis

December 29, 1976

1/ Poverty levels are for non-farm family with head less than 65 years of age and are calculated assuming these annual changes in monthly average of consumer price index:

1976 +5.7%
1977 +5.1%

2/ Taxpayers assumed not eligible for earned income credit. If all income were earned income, the tax-free level of income would have been $6,660 in 1975 and $6,860 in 1976.

Table 11

Current Law and Proposed Social Security Tax

Rate Structure of Tax on Employee Wages 1/

Year	Taxable wage base 2/	OASDHI Rates 1/	
		Current law	Proposed
1976	$15,300	5.85 %	5.85 %
1977	16,500	5.85	5.85
1978	17,700	6.05	6.15
1979	19,200	6.05	6.45
1980	20,700	6.05	6.60
1981	22,200	6.30	6.85
1982	23,700	6.30	6.85

Office of the Secretary of the Treasury
Office of Tax Analysis

December 14, 1976

1/ Employee share only.

2/ Estimated for 1978 and beyond.

Table 12

Proposed Social Security (OASDHI) Tax Burdens 1/

Taxable Wage	Current Law					Proposed Law		
	1976	1977	1978	1979	1980	1978	1979	1980
$ 3,000	$176	$176	$182	$182	$182	$185	$194	$198
5,000	293	293	303	303	303	308	323	330
7,000	410	410	424	424	424	431	452	462
10,000	585	585	605	605	605	615	645	660
15,000	878	878	908	908	908	923	968	990
20,000	895	965	1,071	1,162	1,210	1,089	1,238	1,320
30,000	895	965	1,071	1,162	1,252	1,089	1,238	1,366
40,000	895	965	1,071	1,162	1,252	1,089	1,238	1,366
50,000	895	965	1,071	1,162	1,252	1,089	1,238	1,366

Office of the Secretary of the Treasury
Office of Tax Analysis

January 3, 1977

1/ Employee share only.

Proposed Combined Income Tax and Social Security (OASDHI) Tax Burdens 1/

Married Couple, Two Children

Wage Income	Current Law 1976 2/	Current Law 1977 2/	Current Law 1978 3/	Current Law 1979 3/	Proposed Law 1977	Proposed Law 1978	Proposed Law 1979
$ 3,000	$ 176	$ 176	$ 182	$ 182	$ 176	$ 185	$ 194
5,000	293	293	303	303	293	308	323
7,000	545	545	559	559	470	491	512
10,000	1,236	1,236	1,256	1,256	1,070	1,100	1,130
15,000	2,430	2,430	2,460	2,460	2,203	2,248	2,293
20,000	3,425	3,495	3,601	3,692	3,245	3,369	3,518
30,000	5,799	5,869	5,975	6,066	5,613	5,737	5,886
40,000	8,829	8,899	9,005	9,096	8,629	8,753	8,902
50,000	12,405	12,475	12,581	12,672	12,145	12,269	12,418
100,000	33,275	33,345	33,451	33,542	32,965	33,089	33,238

Office of the Secretary of the Treasury
Office of Tax Analysis

January 3, 1977

1/ Tax calculations assume deductible expenses equal 16 percent of income, OASDHI taxes are employee share only, and one wage earner.

2/ Assumes no earned income credit. Under current law, the earned income credit expires at the end of 1977. With the earned income credit, the lowest three income levels would appear as follows for 1976 and 1977:

Income	Income tax plus OASDHI tax less credit
$3,000	$-124
5,000	-7
7,000	445

3/ Assumes extension of the general tax credit.

Table 14

Proposed Combined Income Tax and Social Security (OASDHI) Tax Burdens 1/

Single Individual

Wage Income	Current Law 1976	Current Law 1977	Current Law 1978 2/	Current Law 1979 2/	Proposed Tax 1977	Proposed Tax 1978	Proposed Tax 1979
$ 3,000	$ 176	$ 176	$ 182	$ 182	$ 176	$ 185	$ 194
5,000	656	656	666	666	600	615	630
7,000	1,124	1,124	1,138	1,138	1,051	1,072	1,093
10,000	1,916	1,936	1,936	1,936	1,812	1,842	1,872
15,000	3,287	3,317	3,317	3,317	3,185	3,230	3,275
20,000	4,562	4,632	4,738	4,829	4,518	4,642	4,791
30,000	7,685	7,755	7,861	7,952	7,620	7,744	7,893
40,000	11,430	11,500	11,606	11,697	11,340	11,464	11,613
50,000	15,630	15,700	15,806	15,897	15,540	15,664	15,813
100,000	36,630	36,700	36,806	36,897	36,540	36,664	36,813

Office of the Secretary of the Treasury
Office of Tax Analysis

January 3, 1977

1/ Tax calculations assume deductible expenses equal 16 percent of income, OASDHI taxes are employee share only.

2/ Assumes extension of the general tax credit.

convinced that this is a far better way to help create jobs in those areas that have lagged behind in the economic recovery than adding layer upon layer of new hastily conceived spending programs.

A year ago, in my 1977 Budget, I noted that the old age, survivors and disability trust funds would be depleted in the early 1980's unless some action was taken. Therefore, much as I didn't like doing it, I felt compelled to recommend payroll tax rate increases beginning January 1, 1977. The employee share of this increase would have amounted to less than one dollar per week for taxpayers at the top end of the pay scale and a few cents per week for those at the bottom. Congress failed to act on this proposal. Partly because of the delay, a higher tax increase is now necessary if the social security system is to remain intact. Because current law already prescribes a four-tenths of one percent increase in the tax rate in 1978, I do not believe that a very large additional increase is appropriate in that year. I am therefore proposing an additional two-tenths of one percent rate increase in 1978 supplemented by a six-tenths of one percent rate increase in 1979 and a three-tenths of one percent rate increase in 1980. These increases will restore the fiscal integrity of the Social Security Trust Funds in the short run and, together with my proposals for correcting the inflation adjustment for future benefits for currently employed workers, will greatly reduce the long-run deficit faced by the social security system.

I have in the past urged several other changes in our tax laws which are both necessary and desirable. These will be proposed again in my budget, but need not be discussed in detail at this time. These include a tax credit for home insulation, exempting charitable contributions from the burden of the minimum tax, increasing the railroad retirement tax in a manner consistent with the recommended Social Security tax increases, and providing State and local governments with an option to issue taxable bonds subsidized in part by the Federal government.

I am also recommending repeal of the earned income credit and the provision for funding Employee Stock Ownership Plans through additional investment tax credits. The earned income credit is not integrated with the rest of our welfare system and makes future reform of that system even more difficult. The Employee Stock Ownership Plan provides a very large taxpayer subsidy to employers who wish to purchase stock in their firm for their employees. I do not believe that this is an equitable approach to the encouragement of stock ownership.

I urge that the Congress take prompt action on all of the above tax proposals.

GERALD R. FORD

THE WHITE HOUSE,

January 4, 1977.

EMBARGOED FOR RELEASE UNTIL 11:00 AM, (EST), TUESDAY, JANUARY 4, 1977

January 4, 1977

Office of the White House Press Secretary

THE WHITE HOUSE

TO THE CONGRESS OF THE UNITED STATES:

In October 1975, I presented to the Congress a program of tax cuts and spending restraints that would have reduced the burden of government for all taxpayers. It would have given the American people more freedom to spend their incomes as they choose rather than as Washington chooses for them. However, Congress decided otherwise -- to increase spending far more than I wanted and to cut taxes far less than I wanted.

My forthcoming 1978 Budget will provide a detailed blueprint for Federal spending. Today, as I promised, I am outlining my proposals for personal and business tax reductions in 1977. First, I again urge a permanent increase in the personal exemption from $750 to $1000 to replace the system of temporary tax credits that have so greatly complicated the individual income tax return. I am also recommending an increase in the low income allowance and a series of permanent tax rate reductions. In total, my proposals provide income tax relief for individuals of approximately $10 billion in 1977. The tax reductions of 1975 and 1976 focused tax relief on the lower income taxpayer. However, it is high time to focus substantial tax relief on middle income taxpayers. The tax relief I seek will cut the 1977 income taxes of a typical family with four with an income of $15,000 by $227.

In the long run, inflation and real economic growth constantly push taxpayers into higher and higher tax brackets if tax law remains unchanged. Some believe that these additional tax receipts should be spent on new Federal programs. I do not. Instead, I believe that the Congress should periodically counteract the growing burden imposed by the tax system by providing offsetting tax cuts while continuing to restrain the rate of growth of Federal spending.

The creation of good permanent jobs for our expanding labor force requires a higher level of private investment. I am, therefore, recommending again a permanent reduction in the corporate income tax from 48 to 46 percent. This would reduce business tax liabilities by $2.5 billion in 1977.

I also urge making permanent the 10 percent investment tax credit and the surtax exemption provisions of the Tax Reform Act of 1976. In the longer run we must eliminate the double taxation of dividend payments. I am, therefore, renewing my proposal to integrate corporate and personal income taxes gradually over a period of years beginning in 1978. All of these changes in the tax laws will increase the funds available, directly and indirectly, for new and better plants, machinery, stores and equipment.

I am again recommending accelerated depreciation for new plants and equipment installed in rural and urban labor market areas where unemployment is 7 percent or higher. I am firmly

more

This document transmits to the Congress in summary form the administration's revisions to the 1978 budget that was presented to the Congress January 17, 1977. It also provides the information required by Section 601(g) of the Congressional Budget Act of 1974 (Public Law 93-344) on budget amendments and revisions to the 1978 budget. This information is being submitted well in advance of the April 10 deadline set in the Act so that it will be of maximum use to the Congress and the congressional budget committees as they begin preparing their reports on the first concurrent resolution on the 1978 budget. Further supporting detail is being made available to the Congress.

FISCAL YEAR 1978 Budget Revisions

February 1977

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GENERAL NOTES

1. All years referred to are fiscal years, unless otherwise noted. Through fiscal year 1976, the Federal Government's fiscal years began on July 1 and ended on June 30. Starting with fiscal year 1977, fiscal years begin on October 1 and end on September 30. The 3-month period between fiscal year 1976 and 1977—July 1, 1976 to September 30, 1976—is designated the transition quarter (TQ).

2. Detail in the tables and text of this volume may not add to the totals because of rounding.

PART 1

MESSAGE OF THE PRESIDENT ON REVISIONS TO THE 1978 BUDGET

MESSAGE OF THE PRESIDENT ON REVISIONS TO THE 1978 BUDGET

To the Congress of the United States:

I am presenting today proposed changes in the 1978 budget.

Although I have not been able to analyze this budget in depth, these proposals do differ significantly from those of the previous administration.

Proposals have been rejected that would have needlessly added to the burden on the elderly and those who depend upon medicare, medicaid, and food programs.

I have withdrawn proposals that would have placed further financial strain on State and local governments.

Changes are included that will help us move more quickly to meet our commitments in such vital areas as the environment, education, and housing; and I am introducing measures that will help us control unacceptable inflation in medical costs.

The planned increase in defense spending, has been reduced while our real military strength is enhanced.

Revisions have been made that reflect new priorities for water resources development and also for energy, placing greater emphasis on conservation, development of non-nuclear power sources, and expanding our petroleum storage program. Later in the spring, work with the Congress will be completed on a comprehensive, long-range national energy policy.

This budget includes the economic stimulus package, which will reduce unemployment and promote steady, balanced economic growth. The package, which has been slightly changed since it was first presented to the Congress last month, provides for $15.7 billion in tax reductions and increased outlays in 1977 and $15.9 billion in 1978. It includes a $50 per capita rebate on personal income taxes; an increase in the standard deduction; reduction in business taxes to stimulate employment and provide incentives for investment; expansion in training and employment programs; increases in public works funding; and additional money for countercyclical revenue sharing grants to State and local governments.

I am also asking the Congress to extend the supplemental payments program, which is now expiring, so that unemployed workers will be able to qualify through the end of this year for up to 52 weeks of unemployment benefits.

There are several important goals which these revisions do not reflect, because my administration has not yet had time to review all current tax and spending programs or fully prepare our own proposals. The 1978 budget is essentially still President Ford's budget, with only such limited revisions as my administration has had time to make. But these revisions do reflect our careful choices among many possible options; they are important first steps toward a Federal Government that is more effective and responsive to our people's needs.

Last year, spending estimates were too high, and economic policymaking was adversely affected. Because time did not permit detailed review of the current estimates, I have instructed the Office of Management and Budget to make a thorough review of these estimates. The Congress will be informed of any resulting revisions.

The revised budget outlined in this document continues to reflect the current overlapping and unwieldy structure of the Federal Government—a structure I intend, with the help of the Congress, to simplify and improve.

Although it has not been possible in these revisions to the 1978 budget, future budgets will reflect detailed, zero-based reviews of Federal spending programs, comprehensive reform of the tax system, and fundamental reorganization of the Government.

JIMMY CARTER

FEBRUARY 22, 1977.

PART 2

BUDGET SUMMARY

BUDGET SUMMARY

Economic assumptions

The following table presents the underlying economic assumptions that have been used for making the budget estimates. In keeping with conventional usage these economic assumptions are presented for calendar years, whereas the budget estimates are presented on a fiscal year basis.

The overall assessment of the economic outlook does not differ greatly from what was shown in the January budget.

Real economic growth and the decline in unemployment are somewhat greater than forecast in the January budget because the President's fiscal stimulus proposals are expected to increase the rate of economic expansion. The inflation forecast is virtually identical to that in the January budget.

The forecast does not reflect the effects of the severe cold weather recently experienced in part of our country, or of continued drought in the West. When the effects of the weather can be more accurately estimated, the economic outlook will be reassessed. It now appears, however, that the overall adverse effects of the severe cold weather will be relatively moderate and temporary, and that real economic activity by the end of the fourth quarter of this calendar year will have recovered nearly all the ground lost due to the cold weather. From the fourth quarter of calendar year 1976 to the final quarter of 1977, real output of goods and services is expected to increase by about 6%.

ECONOMIC FORECAST

(Calendar years; dollar amounts in billions)

Item	Actual 1975	Prel. 1976	Forecast 1977	Forecast 1978
Gross national product:				
Current dollars:				
Amount	1,516	1,692	1,884	2,105
Percent change	7.3	11.6	11.3	11.7
Constant (1972) dollars:				
Amount	1,192	1,265	1,334	1,406
Percent change	−1.8	6.2	5.4	5.4
Incomes (current dollars):				
Personal income	1,250	1,375	1,528	1,698
Wages and salaries	807	890	992	1,108
Corporate profits	115	149	173	197
Price level (percent change):				
GNP deflator:				
Year over year	9.3	5.1	5.6	6.0
Fourth quarter over fourth quarter	7.1	4.7	5.9	5.8
Consumer price index:				
Year over year	9.1	5.7	5.1	5.4
December over December	7.0	4.8	5.3	5.2
Unemployment rates (percent):				
Total	8.5	7.7	7.1	6.3
Insured [1]	7.2	6.4	5.4	4.4
Average Federal pay raise, October (percent)	5.00	4.83	6.50	6.25
Interest rate, 91-day Treasury bills (percent) [2]	5.8	5.0	4.6	4.6

[1] Insured unemployment as a percentage of covered employment.
[2] Average rate on new issues within period; the rate shown for 1977 and 1978 was the current market rate at the time the estimates were made.

Revised budget totals

The revisions proposed in this document result in total budget outlays of $417.4 billion in 1977 and $459.4 billion in 1978. The revisions include both proposed policy changes and reestimates, and involve increases for some programs and decreases for others. The net increase in outlays, compared to the budget recommendations of the previous administration, is $6.2 billion for 1977 and $19.4 billion for 1978.

Changes in receipts estimates include the effects of the tax proposals in this administration's economic stimulus package, the withdrawal of most of the previous administration's tax proposals, and reestimates due to revised economic assumptions and other factors. These changes are shown in detail in Part 3 of this document. The revised estimates of total budget receipts are $349.4 billion for 1977 and $401.6 billion for 1978. The resulting budget deficits are $68.0 billion for 1977 and $57.7 billion for 1978.

THE BUDGET TOTALS

(In billions of dollars)

Item	1976 actual	1977 estimate	1978 estimate
Receipts	300.0	349.4	401.6
Outlays	366.5	417.4	459.4
Deficit (−)	−66.5	−68.0	−57.7

Budget revisions

Review of the budget by the President and members of the administration led to the identification of a number of desirable changes from the budget requests of the previous administration. The net effects of these changes in modifying the original 1978 budget estimates are summarized in the following table.

COMPARISON OF JANUARY AND REVISED BUDGET TOTALS

(In billions of dollars)

Item	1976 actual	1977 estimate	1978 estimate
Outlays:			
January budget	366.5	411.2	440.0
Revisions	--------	6.2	19.4
Revised budget	366.5	417.4	459.4
Receipts:			
January budget	300.0	354.0	393.0
Revisions	--------	−4.7	8.6
Revised budget	300.0	349.4	401.6
Deficit (−):			
January budget	−66.5	−57.2	−47.0
Revisions	--------	−10.8	−10.8
Revised budget	−66.5	−68.0	−57.7

Individual budget revisions are being transmitted to the Congress as rapidly as possible. The revisions assume a number of forms: most involve amended or supplemental appropriation requests, but some require new legislative proposals. Some involve rescissions and deferrals. Some simply represent reestimates based on later information and revised economic assumptions. In other cases, legislative proposals put forward in the January budget but not specifically transmitted to the Congress are being withdrawn and no further action is needed.

Almost all of the revisions, apart from the economic stimulus package, involve the restoration of proposed cutbacks that this administration judged to be unwarranted. Therefore, except for the economic stimulus package, the proposed budget figures are on the whole closer to those needed to maintain current programs at their present levels than were the January budget recommendations. Because of the short time available to make these revisions they do not reflect the zero-base review of programs that this administration will undertake as it formulates its budgets in the future.

FISCAL STIMULUS PROPOSALS

(In billions of dollars)

Item	Estimate 1977	Estimate 1978
$50 rebates and payments	11.4	*
Changes in the standard deduction	1.5	5.7
Business tax incentives	.9	2.4
Public service employment	.7	3.4
Expanded training and youth programs	.3	1.6
Accelerated public works	.2	2.0
Increased countercyclical revenue sharing	.7	.7
Total, receipts and outlays	**15.7**	**15.9**

*Less than $50 million.

The estimates contained in this document are necessarily based on those in the January budget. This administration has not had sufficient time to review in detail the earlier estimates for technical accuracy. For 1977, budget outlays to date suggest the possibility that outlay estimates may be high in some instances. Recent experience also suggests that there tends to be some general upward bias in making outlay estimates. The administration is concerned about these problems and will make a thorough review of the 1977 estimates. As soon as the results of a more detailed review are known, the estimates will be further revised. A special effort is planned to improve the quality of budget outlay estimates in the future.

The following table summarizes the effects of major individual revisions on budget outlays. Effects on receipts are shown in Part 3.

OUTLAY EFFECTS OF BUDGET REVISIONS

(In billions of dollars)

Item	1977 estimate	1978 estimate
Increases in employment and training programs	1.0	6.3
Increased funding for local public works program	.2	2.0
Extension of and increase in countercyclical revenue sharing	.9	1.6
Proposed $50 payments, in excess of tax liabilities	1.4	-------
Social security—$50 bonus	1.8	-------
Earned income credit (extension)	-------	.9
Extension of Federal supplemental unemployment benefits	.5	.4
Unemployment insurance (reestimate)	−1.0	−1.2
Restoration of proposed food stamp and child nutrition reductions	.7	2.1
Restoration of funding levels for health care programs	.3	1.3
Restoration of education program funding levels	*	.5
Increases in veterans benefits	-------	.9
Water resources development	*	−.3
Net increase in energy programs	*	.8
Net decrease in defense	-------	−.3
Changes in foreign economic assistance	−.2	.6
Mortgage credit programs—reestimate	−.4	*
Transportation program increases (highways and railroads)	-------	.4
Increases in funding for social services	-------	.3
Interest (reestimate)	.3	2.0
Offshore oil-land leasing receipts (change in timing)	.3	−.3
All other revisions (net)	.4	1.4
Total revisions	6.2	19.4

*$50 million or less.

Grants-in-aid to State and local governments

The largest proposed 1978 outlay increases over the January budget levels are in the area of temporary grants-in-aid to State and local governments. The following table illustrates this fact:

PROPOSED OUTLAYS BY CATEGORY

(In billions of dollars)

	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
National defense	90.0	100.1	100.1	112.3	111.9
Grants-in-aid	(59.0)	(70.4)	(72.4)	[1] (71.1)	(81.7)
Countercyclical programs [2]	1.9	4.4	6.2	1.8	9.9
Other grants	57.2	66.0	66.2	69.3	71.8
Payments for individuals	(19.5)	(23.5)	(23.6)	[1] (25.0)	(25.8)
All other grants	(37.6)	(42.5)	(42.6)	(44.3)	(46.0)
Other outlays	217.4	240.7	244.9	256.6	265.7
Total	366.5	411.2	417.4	440.0	459.4

[1] Excludes $500 million for low income housing assistance erroneously classified as grants-in-aid in the January budget.
[2] Includes local public works, some Comprehensive Employment and Training Act programs, and antirecession fiscal assistance; approximately $1.6 billion in 1977 and $6.2 billion in 1978 are part of the administration's economic stimulus package.

As the table shows, \$10.6 billion—55% of the \$19.4 billion 1978 outlay revision—is for grant-in-aid programs. The increase in grants includes \$8.1 billion for temporary programs to stimulate the economy and \$2.5 billion in other grant programs. A \$1.8 billion increase in grant-in-aid outlays for economic stimulus is proposed for 1977. Spending from 1977 and 1978 budget authority for these programs will continue in 1979 and beyond.

Total grant-in-aid outlays are estimated to be \$81.7 billion in 1978, a 38% increase over the 1976 total of \$59.0 billion. This large increase results primarily from temporary stimulus programs. As the economy improves, outlays for grants-in-aid are expected to return to more normal levels.

Budget authority

Total budget authority under the revised budget is \$464.0 billion for 1977 and \$507.3 billion for 1978. Of the 1978 total, \$338.7 billion, or 67%, will require appropriations and other new action by the Congress. The rest will be available under existing laws.

The revisions proposed in this document add \$28.1 billion to the amount proposed for 1977 in the January budget and \$26.8 billion for 1978. (These overall increases are the net effect of decreases as well as increases.) The largest single component of the 1977 and 1978 increases is \$24.5 billion for the subsidized housing programs, which will be spent over a 15- to 40-year period (only \$70 million of this amount will be spent in 1978).

The following table summarizes the changes in budget authority requests.

CHANGES IN BUDGET AUTHORITY BY AGENCY

(In billions of dollars)

Agency	1977 estimate			1978 estimate		
	January budget	Revised budget	Change	January budget	Revised budget	Change
Legislative branch	1.0	1.0	-------	1.1	1.1	-------
The Judiciary	.4	.4	-------	.4	.4	-------
Executive Office of the President	.1	.1	*	.1	.1	*
Funds appropriated to the President	3.4	3.2	−0.2	4.1	5.3	1.3
Department of Agriculture	13.2	13.9	.8	12.4	14.6	2.2
Department of Commerce	4.0	6.0	2.0	1.9	4.2	2.3
Department of Defense—Military	108.3	108.3	-------	121.7	118.9	−2.8
Department of Defense—Civil	2.5	2.5	-------	2.6	2.6	−*
Department of Health, Education, and Welfare	146.5	146.7	.2	161.1	162.2	1.1
Department of Housing and Urban Development	20.5	35.9	15.4	29.7	39.2	9.5
Department of the Interior	4.2	3.4	−.8	3.6	3.6	−0.1
Department of Justice	2.3	2.3	*	2.3	2.3	*
Department of Labor	24.4	26.2	1.8	20.7	26.6	6.0
Department of State	1.3	1.3	*	1.4	1.4	*
Department of Transportation	9.1	9.1	-------	13.0	13.3	.3
Department of the Treasury	49.6	54.0	4.4	51.0	55.7	4.7
Energy Research and Development Administration	6.4	6.4	-------	7.8	7.8	−.1
Environmental Protection Agency	1.9	6.0	4.2	5.3	5.3	*
General Services Administration	.2	.2	-------	.2	.3	*
National Aeronautics and Space Administration	3.7	3.7	-------	4.0	4.0	*
Veterans Administration	19.0	19.0	-------	18.2	19.0	.9
Other independent agencies	29.3	29.4	.1	31.2	32.9	1.8
Allowances:						
Civilian agency pay raises	-------	-------	-------	1.2	1.2	-------
Contingencies for other requirements	-------	-------	-------	1.8	1.8	-------
Undistributed offsetting receipts:						
Employer share, employee retirement	−4.6	−4.6	*	−4.7	−4.7	*
Interest received by trust funds	−8.2	−8.2	*	−8.7	−8.6	.1
Rents and royalties on the Outer Continental Shelf	−2.6	−2.3	.3	−3.1	−3.4	−.3
Total budget authority	435.9	464.0	28.1	480.4	507.3	26.8

*$50 million or less.

Off-budget Federal entities

The off-budget Federal entities are federally owned and controlled, but their transactions have been excluded from the budget totals under provisions of law. Therefore, their spending is not reflected in the budget outlays or the budget surplus or deficit, appropriation requests for their activities are not included in the totals of budget authority, and their outlays are not subject to the ceilings set by the congressional budget resolutions. Off-budget outlays are added to the budget deficit to comprise the total Government deficit, which has to be financed by borrowing from the public or by other means.

The exclusion of these Federal entities from the budget developed over the last few years. This has eroded the comprehensive budget coverage that was established as a result of the recommendations of the President's Commission on Budget Concepts in 1967. Comprehensive coverage is necessary in order to inform the President, the Congress, and the public accurately about the size, scope, and composition of the Federal Government's operations, and thereby would provide the proper context within which to establish priorities among alternative governmental programs and between public and private activities. Therefore, this administration is now intensively reviewing the treatment of each of the off-budget Federal entities and will provide recommendations to the Congress at an early date.

Off-budget outlays are estimated to be $8.5 billion in 1978. The total is $650 million less than in the January budget, because this administration does not support the recommendation in the January budget to create the Energy Independence Authority. The estimates for all other off-budget Federal entities are unchanged in both 1977 and 1978.

OUTLAYS OF OFF-BUDGET FEDERAL ENTITIES

(In millions of dollars)

Off-budget Federal entity	1976 actual	1977 estimate	1978 estimate
Federal Financing Bank	5,863	8,741	5,936
Rural electrification and telephone revolving fund	213	456	-------
Rural Telephone Bank	93	95	92
Housing for the elderly or handicapped fund	−15	262	738
Pension Benefit Guaranty Corporation	−22	−14	−16
Exchange stabilization fund	−74	−58	−58
Postal Service fund	1,085	1,006	1,815
U.S. Railway Association	52	298	-------
Energy Independence Authority (proposed legislation, January budget)	-------	-------	650
Total, January budget	**7,196**	**10,785**	**9,156**
Effect of withdrawing proposed legislation	-------	-------	−650
Total, revised estimates	**7,196**	**10,785**	**8,506**

Debt

The budget deficits now estimated for 1977 and 1978, together with the deficits of the off-budget Federal entities and the other factors involved in budget financing, require that the Federal Government borrow $73.0 billion from the public in 1977 and $65.8 billion in 1978. It is anticipated that the supply of funds in the economy will permit this borrowing to be financed without seriously adverse effects on the availability of funds for the private sector or on interest rates.

The following table shows the relationship between deficits, the change in debt held by the public, and the change in gross Federal debt.

BUDGET FINANCING AND DEBT

(In billions of dollars)

Description	1976 actual	1977 estimate	1978 estimate
Budget surplus or deficit (−)	−66.5	−68.0	−57.7
Deficit (−), off-budget Federal entities	−7.2	−10.8	−8.5
Means of financing other than borrowing from the public	[1] −9.7	5.8	.5
Change in debt held by the public	83.4	73.0	65.8
Change in Federal agency investments in Federal debt	4.3	7.7	9.5
Change in gross Federal debt	87.7	80.7	75.3
Outstanding debt, end of year:			
Gross Federal debt	631.9	727.0	802.4
Held by:			
Government agencies	151.6	155.7	165.2
The public	480.3	571.3	637.1
Debt subject to limit	621.6	717.9	794.7

[1] Includes reclassification of securities.

PART 3

BUDGET RECEIPTS

BUDGET RECEIPTS

Total budget receipts in 1978 are estimated at $401.6 billion, an increase of $52.2 billion from the $349.4 billion estimated for 1977. These estimates are based on the economic assumptions presented in Part 2 and the legislative proposals described below.

BUDGET RECEIPTS BY SOURCE

(In billions of dollars)

Source	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
Individual income taxes	131.6	153.1	148.9	171.2	179.2
Corporation income taxes	41.4	56.6	57.2	58.9	61.6
Social insurance taxes and contributions	92.7	108.9	108.0	126.1	123.8
Excise taxes	17.0	17.9	17.9	18.5	18.6
Estate and gift taxes	5.2	5.9	5.9	5.8	5.8
Customs duties	4.1	4.7	4.7	5.3	5.3
Miscellaneous receipts	8.0	6.9	6.7	7.2	7.2
Total budget receipts	**300.0**	**354.0**	**349.4**	**393.0**	**401.6**

Receipts are now estimated to be $4.7 billion lower than in the January budget for 1977 and $8.6 billion higher for 1978. Substitution of the administration's tax proposals for those presented in the January budget reduces receipts by $3.8 billion in 1977 and increases receipts by $6.7 billion in 1978. The remaining differences—a decrease of $0.9 billion in 1977 and an increase of $1.9 billion in 1978—are due to revised economic assumptions and other factors.

The principal purpose of the President's tax proposals is to provide immediate economic stimulus while leaving open the way for permanent improvements in the tax structure. To achieve this goal, the largest part of the economic stimulus package is a tax rebate that will raise peoples' after-tax incomes this spring. This tax reduction, together with the smaller and permanent tax reductions proposed, will help to strengthen the rate of economic expansion quickly without committing large amounts of future tax resources. These resources will thus remain available for the permanent tax proposals that will be submitted to the Congress this fall after the administration has made a careful and comprehensive review of the tax structure. The proposals forthcoming will reflect the President's commitment to the American people to develop a fairer, more efficient, and less complicated tax structure than we have now. To allow the Congress adequate time to consider these proposals, legislation is now proposed to extend for 1 year the temporary provisions of the Tax Reform Act of 1976 that are currently scheduled to expire on December 31, 1977.

COMPARISON BETWEEN JANUARY BUDGET ESTIMATES OF RECEIPTS AND REVISED ESTIMATES

(In billions of dollars)

Description	Estimate 1977	Estimate 1978
January budget estimates	354.0	393.0
Removal of Ford administration proposals	6.9	22.5
Revised economic assumptions and other factors	–.9	1.9
Estimated receipts under current tax law	360.0	417.4
Fiscal stimulus proposals [1]	–10.6	–7.9
Extension of temporary tax reductions	--------	–7.8
Other proposals	–*	–*
Revised budget estimates	349.4	401.6

*$50 million or less.
[1] Excludes payments in excess of tax liabilities. These payments are treated as budget outlays.

The tax part of the economic stimulus package contains three proposals. They are:

—A $50 rebate per person to taxpayers and their dependents. This rebate will reduce 1977 receipts by $8.2 billion. A $50 payment is also to be made to recipients of social security, supplemental security income, and railroad retirement, and to recipients of the earned income credit and certain other persons with earned income but limited tax liability. These payments are treated as outlays in the budget.

—A permanent simplification of the standard deduction. A flat deduction of $2,200 for single persons and $3,000 for joint returns is proposed as a substitute for the present complex set of standard deductions. Simplification also includes extension of the $35 credit to exemptions for age and blindness to facilitate use of simplified tax tables. At current income levels, the changes decrease receipts by about $4 billion on an annual basis. It is assumed that the decrease in withholding due to these changes will occur at the beginning of May. Since the lower withholding will not be in effect for the first 4 months of calendar year 1977, affected taxpayers will either make smaller tax payments or receive larger refunds in the spring of 1978. Consequently, the reduction in receipts attributable to these proposals is less than for a full year in fiscal year 1977 ($1.5 billion) and more than for a full year in fiscal year 1978 ($5.6 billion).

—A permanent business tax reduction. Businesses will be given a choice between either a 2 percentage point increase in the present 10% investment credit, or a refundable credit against income taxes equal to 4% of social security payroll taxes (FICA) and 2% of railroad retirement and self-employment taxes. Businesses will not be permitted to change their choice once made. It is estimated that this proposal will reduce receipts by $0.9 billion in 1977 and $2.3 billion in 1978. Payments to businesses in excess of their tax liability are treated as outlays.

In total, these tax proposals for economic stimulus reduce receipts by $10.6 billion in 1977 and $7.9 billion in 1978.

The temporary provisions of the Tax Reform Act of 1976 that are proposed to be extended for 1 year are:

—a $35 tax credit per exemption or a credit equal to 2% of the taxpayer's taxable income up to $9,000, whichever is larger;

—extension of the earned income credit for families with dependent children, equal to 10% of earned income subject to a maximum of $400; and

—corporate rate reductions from 22% to 20% on the first $25,000 of income and from 48% to 22% on the second $25,000.

The revised estimates also include five proposals that were contained in the January budget: legislation to require employers to pay social security taxes on employee income derived from tips; a taxable municipal bond option to improve the efficiency of the municipal market; authorization for the Nuclear Regulatory Commission to collect fees to cover the costs of its licensing services, including its reactor safety research program; authorization to require navigators of Federal waterways, canals, locks, and channels to pay user fees to help defray the costs of such waterways; and an increase in the migratory bird hunting stamp from $5 to $10. All other legislative proposals in the January budget with regard to receipts have been dropped.

The revised estimates also include proposed legislation to hold the monthly supplemental medical insurance (medicare) premium at its current level of $7.20 through September 1978. Under existing law, this premium is scheduled to rise to $7.70 in July 1977 and to an estimated $8.10 in July 1978.

PROPOSED LEGISLATION INCLUDED IN THE REVISED ESTIMATES OF RECEIPTS

(In billions of dollars)

Description	Estimate 1977	Estimate 1978
Fiscal stimulus proposals:		
Individual income tax	−9.9	−6.1
$50 rebate	(−8.2)	(.....)
Simplification proposals	(−1.5)	(−5.6)
Business tax credits	(−.1)	(−.5)
Corporation income tax	−.7	−1.8
Subtotal	−10.6	−7.9
Extension of temporary tax provisions:		
Individual income tax	....	−6.8
Corporation income tax	....	−1.0
Subtotal	....	−7.8
Other proposals	−*	−*
Total proposed legislation	−10.7	−15.8

*$50 million or less.

The revised estimates, like the estimates in the January budget, include the effect of tax changes that are scheduled to occur under current law, such as increases in the social security tax rate and base, increases in the unemployment insurance tax base, and a continued phaseout of the telephone excise tax.

PART 4

THE FEDERAL PROGRAM BY FUNCTION

Introduction

This section discusses the revised budget authority and outlay estimates in terms of the major functions or purposes being served. The functional budget classification presents budget authority and outlays for each major purpose, regardless of which agency carries out the activity and without double counting. The functional classification is also the major basis used for budget control under the Congressional Budget Act of 1974. The concurrent resolutions called for under the Act specify totals for each function, although the budget authority and outlay ceilings apply only to the totals.

BUDGET AUTHORITY BY FUNCTION

(In billions of dollars)

Function	1977 estimate			1978 estimate		
	January budget	Revised budget	Change	January budget	Revised budget	Change
National defense	108.5	108.5	-------	122.9	120.1	−2.7
International affairs	8.2	8.0	−.3	9.0	10.3	1.3
General science, space, and technology	4.5	4.5	-------	4.9	4.9	*
Natural resources, environment, and energy	14.3	17.7	3.4	19.1	20.5	1.4
Agriculture	1.7	1.7	*	2.7	2.7	-------
Commerce and transportation	15.0	15.0	.1	18.7	19.5	.8
Community and regional development	8.7	10.6	1.9	6.4	9.3	2.9
Education, training, employment, and social services	21.8	24.6	2.9	18.0	26.7	8.7
Health	40.4	40.3	−*	47.4	47.8	.4
Income security	155.4	174.1	18.6	170.2	179.8	9.7
Veterans benefits and services	19.1	19.1	-------	18.2	19.1	.9
Law enforcement and justice	3.6	3.6	*	3.7	3.8	.1
General government	3.7	3.7	*	3.9	3.9	*
Revenue sharing and general purpose fiscal assistance	8.5	9.4	.9	9.1	10.7	1.6
Interest	38.0	38.2	.3	39.7	41.8	2.0
Allowances:						
Civilian agency pay raises	-------	-------	-------	1.2	1.2	-------
Contingencies	-------	-------	-------	1.8	1.8	-------
Undistributed offsetting receipts:						
Employer share, employee retirement	−4.6	−4.6	*	−4.7	−4.7	*
Interest received by trust funds	−8.2	−8.2	*	−8.7	−8.6	.1
Rents and royalties on the Outer Continental Shelf	−2.6	−2.3	.3	−3.1	−3.4	−.3
Total budget authority	**435.9**	**464.0**	**28.1**	**480.4**	**507.3**	**26.8**

*$50 million or less.

OUTLAYS BY FUNCTION

(In billions of dollars)

Function	1977 estimate			1978 estimate		
	January budget	Revised budget	Change	January budget	Revised budget	Change
National defense	100.1	100.1	-------	112.3	111.9	-.3
International affairs	7.1	6.9	-.2	7.3	7.8	.6
General science, space, and technology	4.4	4.5	*	4.7	4.7	*
Natural resources, environment, and energy	17.1	17.1	.1	19.7	20.5	.8
Agriculture	2.9	2.9	-------	2.3	2.3	-------
Commerce and transportation	16.1	15.8	-.3	19.3	20.1	.8
Community and regional development	7.7	8.0	.3	7.9	10.0	2.1
Education, training, employment, and social services	21.1	22.2	1.1	19.4	26.5	7.1
Health	39.3	39.5	.3	43.2	44.5	1.3
Income security	138.1	141.6	3.5	143.9	146.5	2.7
Veterans benefits and services	18.4	18.4	-------	18.3	19.1	.9
Law enforcement and justice	3.7	3.7	-*	3.8	3.9	.1
General government	3.7	3.8	*	3.9	3.9	*
Revenue sharing and general purpose fiscal assistance	8.9	9.9	.9	8.1	9.7	1.6
Interest	38.0	38.2	.3	39.7	41.8	2.0
Allowances:						
Civilian agency pay raises	-------	-------	-------	1.2	1.2	-------
Contingencies	-------	-------	-------	1.5	1.5	-------
Undistributed offsetting receipts:						
Employer share, employee retirement	-4.6	-4.6	*	-4.7	-4.7	*
Interest received by trust funds	-8.2	-8.2	*	-8.7	-8.6	.1
Rents and royalties on the Outer Continental Shelf	-2.6	-2.3	.3	-3.1	-3.4	-.3
Total outlays	**411.2**	**417.4**	**6.2**	**440.0**	**459.4**	**19.4**

*$50 million or less.

050: National Defense

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Department of Defense—Military:					
Military personnel	25,430	26,210	26,210	26,193	26,140
Retired military personnel	7,326	8,238	8,238	9,036	9,036
Operation and maintenance	28,848	32,175	32,175	34,168	34,358
Procurement	20,991	27,672	27,672	35,143	32,209
Research, development, test, and evaluation	9,451	10,478	10,478	11,980	11,717
Military construction	2,360	2,147	2,147	1,376	1,677
Family housing	1,229	1,197	1,197	1,329	1,339
Revolving funds and other	77	141	141	95	95
Allowances:					
Civilian and military pay raises:					
Existing law	--------	--------	--------	2,493	2,493
Proposed legislation	--------	--------	--------	−167	−167
Other legislation:					
Retired military personnel	--------	--------	--------	32	7
Military personnel and O. & M.	--------	--------	--------	26	26
Subtotal	95,712	108,260	108,260	121,704	118,929
Military assistance:					
Foreign military sales trust fund	5,427	−2,291	−2,291	−1,884	−1,884
Other military assistance	1,094	674	674	666	663
Subtotal	6,521	−1,617	−1,617	−1,218	−1,220
Atomic energy defense activities	1,682	1,935	1,935	2,380	2,380
Defense-related activities:					
Existing law	−101	−55	−55	236	49
Proposed legislation	--------	--------	--------	−229	--------
Subtotal	−101	−55	−55	7	49
Deductions for offsetting receipts	−3	−3	−3	−3	−3
Total budget authority	**103,811**	**108,520**	**108,520**	**122,871**	**120,136**
OUTLAYS:					
Department of Defense—Military:					
Military personnel	25,064	26,212	26,212	26,005	25,959
Retired military personnel	7,296	8,234	8,234	9,035	9,035
Operation and maintenance	27,902	31,146	31,146	33,539	33,686
Procurement	15,964	18,710	18,710	23,786	23,510
Research, development, test, and evaluation	8,923	9,993	9,993	11,350	11,181
Military construction	2,019	2,087	2,087	2,046	2,058
Family housing	1,192	1,442	1,442	1,518	1,518
Revolving funds and other	−332	226	226	−71	−71
Allowances:					
Civilian and military pay raises:					
Existing law	--------	--------	--------	2,417	2,417
Proposed legislation	--------	--------	--------	−160	−160
Other legislation:					
Retired military personnel	--------	--------	--------	32	7
Military personnel and O. & M.	--------	--------	--------	26	26
Subtotal	88,036	98,050	98,050	109,523	109,166

050: NATIONAL DEFENSE (in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
Military assistance:					
Foreign military sales trust fund	−600	−465	−465		
Other military assistance	1,101	715	715	577	576
Subtotal	501	250	250	577	576
Atomic energy defense activities	1,565	1,829	1,829	2,162	2,162
Defense-related activities:					
Existing law	−103	−52	−52	232	45
Proposed legislation				−229	
Subtotal	−103	−52	−52	3	45
Deductions for offsetting receipts	−3	−3	−3	−3	−3
Total outlays	89,996	100,075	100,075	112,262	111,947

The administration proposes budget revisions that reduce spending for the national defense function.

Because the budget revisions had to be prepared in a short-time, radical changes in defense programs and strategy are not now proposed. A major review of U.S. defense policy and military programs has been initiated, however, and the results of this review will be reflected in the 1979 budget.

The preliminary assessment is that the currently planned force structure is generally consistent with our defense needs, but that the efficiency of our military programs can be improved. The revisions proposed for 1978 are designed to begin this improvement.

The revised request for national defense in 1978 is $120.1 billion in budget authority and $111.9 billion in outlays. These levels represent reductions from the level requested in the January budget of $2.7 billion in budget authority and $0.3 billion in outlays.

Most of the revisions for Department of Defense military functions are reductions resulting from slowing down the rate, or postponing the initiation, of various procurement and operations and maintenance programs, although there are some production cancellations. Several high priority increases in readiness and combat capability that were not sought in January are now being proposed. In addition, a number of reductions and reforms proposed in January are included in the revised request because they will result in greater efficiency.

The underlying rationale behind the proposed revisions is to:

—Defer or slow down programs that would restrict the administration's flexibility to carry out the findings of its review of national defense strategy and programs. Development of the Army's advanced attack helicopter and the Air Force's new M–X strategic missile are being slowed down and no additional funds are provided for the Navy's patrol hydrofoil program.

—Slow down the acquisition of expensive new weapon systems, the justification for which should be subject to a thorough review. Production of B–1 aircraft will be reduced from 8 to 5 and the F–15 will be reduced from 108 to 78 aircraft.

—End procurement of weapons for which no continuing military requirement is clear. Procurement of the Army's nonnuclear Lance missile and the Navy's A–7E attack aircraft will be terminated.

—Increase combat capability where obvious improvements can be obtained at modest cost. Additional funds are provided for tactical aircraft shelters and Army storage facilities in Europe, and for overhaul and repair of equipment.

—Increase program efficiency so as to reduce costs without impairing effectiveness. Naval reserve paid drill strength will be reduced by 40,000.

—Endorse reductions and reforms identified in the January budget, wherever justified. The decision not to provide funds for either the new Nimitz class aircraft carrier or conversion of the nuclear powered cruiser (*Long Beach*) is reaffirmed.

Selected reductions in budget authority totaling $0.4 billion are recommended for strategic forces in 1978. Despite these reductions, the revised request permits real growth in the resources devoted to strategic programs, although at a slower pace than proposed in January. The resulting program will maintain the ability of U.S. strategic forces to deter aggression and preserve a stable world balance of nuclear forces.

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Adjustments are also recommended to decrease the rate of modernization of the general purpose forces. At the same time, additional funds are provided to increase the readiness and combat capability of forces oriented primarily toward the defense of the North Atlantic Treaty Organization nations. The resulting program will provide substantial real growth in modernization and readiness while lowering 1978 budget authority by $2.3 billion. Planned general purpose forces are sufficient to maintain, for the time being, the conventional force balance in Central Europe, keep open the sea lanes of communication to Europe and Northeast Asia, help South Korea maintain stability in Northeast Asia and provide effective power to deal with contingencies that might arise.

The administration endorses the rescission of $721 million (less unrecoverable funds) in 1977 proposed in the January budget for a fourth Nimitz class aircraft carrier and for conversion of the cruiser *Long Beach*. This action will also avoid the need to appropriate $2.0 billion in 1978 to complete these programs.

Two of the compensation-related initiatives recommended in January are strongly endorsed by the administration. A Presidential commission is to be established to review the findings of the Third Quadrennial Review of Military Compensation and to provide independent recommendations to the President. This commission will also be asked to review the military retirement system. Accordingly, the budget does not anticipate enactment of a retirement modernization act. In addition, the reforms of the Federal wage system recommended by the President's Panel on Federal Compensation are embodied in a draft bill that has already been submitted to the Congress. This legislation would correct those provisions of current law that cause significant departures from the local prevailing rate principle, and result in an unfair competitive advantage for the Federal Government and unjustifiable payroll costs. Early enactment of these reforms is strongly recommended by the administration.

A moratorium on defense-related stockpile acquisitions and disposals is in effect pending a review of stockpile policy.

150: International Affairs

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Foreign economic and financial assistance:					
Security supporting assistance	1,690	1,735	1,735	1,459	1,887
Middle East special requirements fund	50	23	23	25	25
International financial institutions	696	1,285	1,285	1,985	2,616
International organizations	202	244	244	226	256
International fund for agricultural development	200	--------	--------	--------	--------
Agency for International Development	999	1,116	1,116	1,280	1,279
Overseas Private Investment Corporation	--------	--------	--------	150	150
Sahel development program (proposed legislation)	--------	--------	--------	50	50
Food for Peace	1,090	1,169	1,169	923	923
Migration and refugee assistance	46	40	47	40	45
Peace Corps	81	81	81	68	75
Other assistance	43	68	68	44	44
Subtotal	5,097	5,761	5,768	6,250	7,350
Conduct of foreign affairs:					
Administration of foreign affairs	484	624	651	714	716
International organizations and conferences	272	400	401	400	401
Other conduct of foreign affairs	26	29	29	32	32
Subtotal	782	1,053	1,081	1,146	1,148
Foreign information and exchange activities:					
Foreign information activities	356	317	317	336	336
Educational exchange activities	67	75	75	83	83
Subtotal	423	392	392	420	420
International financial programs:					
Export-Import Bank	728	1,274	1,274	1,622	1,622
Balance of payments loan for Portugal (proposed legislation)	--------	300	--------	130	300
Offsetting receipts	−20	−20	−20	−20	−20
Subtotal	708	1,554	1,254	1,732	1,902
Deductions for offsetting receipts	−446	−512	−512	−527	−527
Total budget authority	6,564	8,247	7,982	9,021	10,293

The 1978 budget revisions for international affairs include:

—increases for security supporting assistance to Middle East countries;

—increases for international financial institutions; and

—a shift in the start of proposed balance of payments assistance to Portugal from 1977 to 1978.

150: INTERNATIONAL AFFAIRS (in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
OUTLAYS:					
Foreign economic and financial assistance:					
Security supporting assistance	601	1,457	1,524	1,431	1,786
Middle East special requirements fund	35	36	36	38	38
Indochina assistance	65	11	11	--------	--------
International financial institutions	902	868	868	1,059	1,059
International organizations	143	217	217	223	248
International fund for agricultural development	--------	2	2	12	12
Agency for International Development	1,001	1,187	1,187	1,206	1,206
Overseas Private Investment Corporation	−48	−35	−35	−8	−8
Inter-American Foundation	7	8	8	8	8
Sahel development program (proposed legislation)	--------	--------	--------	5	5
Food for Peace	693	1,091	1,091	1,094	1,094
Migration and refugee assistance	42	51	58	39	44
Peace Corps	69	87	82	71	77
Other assistance	58	80	80	42	42
Subtotal	3,568	5,059	5,129	5,221	5,611
Conduct of foreign affairs:					
Administration of foreign affairs	411	614	621	685	690
International organizations and conferences	291	386	387	375	376
Other conduct of foreign affairs	24	30	30	31	31
Subtotal	726	1,030	1,038	1,091	1,096
Foreign information and exchange activities:					
Foreign information activities	317	326	326	342	342
Educational exchange activities	65	68	68	80	80
Subtotal	382	394	394	422	422
International financial programs:					
Export-Import Bank	856	899	899	964	964
Balance of payments loan for Portugal (proposed legislation)	--------	300	--------	130	300
Offsetting receipts	−20	−20	−20	−20	−20
Subtotal	836	1,179	879	1,074	1,244
Deductions for offsetting receipts	−446	−512	−512	−527	−527
Total outlays	5,067	7,150	6,926	7,281	7,847

The revised request for 1978 budget authority is $1.3 billion higher than that proposed in January, and outlays are estimated to be $0.6 billion higher.

Foreign economic and financial assistance.—The revised budget authority request for 1978 security supporting assistance programs to Middle East countries is $458 million higher than the January budget. This is partially offset by net decreases of $30 million in other security supporting assistance programs. Outlays for security supporting assistance are estimated to increase over the January budget estimate by $66 million in 1977 and by $355 million in 1978 due to the requested program increases and reestimates of spendout levels of current programs.

For international financial institutions, a budget authority increase of $631 million in 1978 is proposed for United States callable capital subscriptions to the World Bank and the Inter-American Development Bank. The January budget assumed that these subscriptions would not require appropriations, but it is now believed desirable to seek such appropriations. Because these funds would represent only guarantees for borrowing by these institutions, no outlays are estimated to occur.

The revised request also includes $30 million in budget authority for increased voluntary contributions to the United Nations development program and to the United Nations university endowment fund. The proposed increase for migration and refugee assistance is to continue programs for Indochinese refugees in Southeast Asia. Proposed increases for the Peace Corps would support a level of volunteers commensurate with 1977 training capacity.

International financial programs.—The budget provides for United States participation in a multilateral, 3-year balance-of-payments loan program for Portugal. In the January budget the U.S. share was proposed to be $300 million in 1977, $130 million in 1978, and $120 million in 1979. To allow time for negotiations among the participants, it is now proposed to initiate the program in 1978 with a $300 million U.S. contribution. The second and third installments are also being deferred one year.

250: General Science, Space, and Technology

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate: January budget	1977 estimate: Revised budget	1978 estimate: January budget	1978 estimate: Revised budget
BUDGET AUTHORITY:					
General science and basic research:					
National Science Foundation	717	779	779	889	889
Energy Research and Development Administration	320	372	372	429	429
Smithsonian Institution	2	2	2	2	2
Subtotal	1,039	1,153	1,153	1,320	1,320
Space flight	1,957	2,039	2,039	2,182	2,182
Space science, applications, and technology	944	949	949	1,024	1,039
Supporting space activities	326	357	357	391	391
Deductions for offsetting receipts	−3	−2	−2	−2	−2
Total budget authority	**4,262**	**4,496**	**4,496**	**4,915**	**4,930**
OUTLAYS:					
General science and basic research:					
National Science Foundation	733	737	737	825	825
Energy Research and Development Administration	299	339	339	388	388
Smithsonian Institution	2	2	2	2	2
Subtotal	1,035	1,077	1,077	1,216	1,216
Space flight	2,000	2,044	2,071	2,156	2,156
Space science, applications, and technology	980	960	960	974	986
Supporting space activities	358	354	354	381	381
Deductions for offsetting receipts	−3	−2	−2	−2	−2
Total outlays	**4,370**	**4,434**	**4,461**	**4,725**	**4,737**

The revised budget for general science, space, and technology reflects a $27 million increase in 1977 for a rephasing of outlay requirements for the space shuttle, and a $12 million increase in 1978 outlays for space science and applications programs.

Budget authority proposed for 1978 increases by $15 million. This increase includes $5 million to initiate procurement of a complete backup satellite for Landsat–D, a second-generation Earth resources survey satellite. Estimated total cost of the backup satellite is $60 million over 6 years. Also included is $10 million for additional technical assessments of alternative Mars follow-on missions. The additional $10 million will bring the total for these studies to $15 million in 1978.

300: Natural Resources, Environment, and Energy

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
BUDGET AUTHORITY:					
Water resources and power:					
Water resources development	3, 104	3, 665	3, 672	3, 691	3, 437
Proposed legislation	--------	--------	--------	8	--------
Power	9, 862	−138	−138	−140	−134
Subtotal	12, 966	3, 528	3, 534	3, 558	3, 302
Conservation and land management:					
Forest Service	800	1, 052	1, 052	1, 110	1, 124
Bureau of Land Management	253	293	297	324	325
Agriculture conservation programs	474	491	491	258	464
Proposed legislation	--------	--------	--------	90	--------
Other, including offsetting receipts	−325	−439	−439	−394	−394
Subtotal	1, 202	1, 396	1, 400	1, 388	1, 519
Recreational resources:					
Land and water conservation fund	347	588	588	630	630
Operation of recreation resources	528	1, 491	658	756	900
Proposed legislation	--------	--------	--------	10	10
Subtotal	875	2, 079	1, 245	1, 396	1, 540
Pollution control and abatement:					
Sewage plant construction grants	--------	1, 080	5, 180	--------	--------
Proposed legislation	--------	--------	--------	4, 500	4, 500
Other pollution control	684	702	776	715	756
Subtotal	684	1, 782	5, 956	5, 215	5, 256
Energy:					
Energy Independence Authority (proposed legislation)	--------			42	--------
Storage, conservation, and resource development	1, 062	1, 831	1, 855	2, 984	4, 397
Proposed legislation	--------	--------	--------	−159	−159
Regulation	196	222	223	236	238
Research and development	2, 183	3, 188	3, 188	3, 994	3, 902
Proposed legislation	--------	--------	--------	295	300
Subtotal	3, 441	5, 240	5, 265	7, 392	8, 678
Other natural resources	921	1, 055	1, 055	1, 146	1, 163
Deductions for offsetting receipts	−807	−800	−800	−997	−997
Total budget authority	**19, 283**	**14, 279**	**17, 655**	**19, 098**	**20, 462**
OUTLAYS:					
Water resources and power:					
Water resources development	2, 857	3, 850	3, 857	3, 687	3, 433
Proposed legislation	--------	--------	--------	8	--------
Power	743	939	939	1, 200	1, 206
Subtotal	3, 600	4, 790	4, 796	4, 895	4, 638

(In millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
OUTLAYS—Continued					
Conservation and land management:					
Forest Service	916	1,138	1,138	993	1,005
Bureau of Land Management	231	296	300	315	315
Agriculture conservation programs	432	481	481	441	497
Proposed legislation				22	
Other, including offsetting receipts	−333	−452	−452	−402	−402
Subtotal	1,245	1,464	1,468	1,370	1,416
Recreational resources:					
Land and water conservation fund	276	458	502	523	504
Operation of recreation resources	619	779	782	848	928
Proposed legislation				10	10
Subtotal	895	1,237	1,284	1,381	1,442
Pollution control and abatement:					
Sewage plant construction grants	2,429	4,430	4,430	4,970	5,140
Proposed legislation				190	20
Other pollution control	638	766	780	753	820
Subtotal	3,067	5,196	5,210	5,913	5,980
Energy:					
Energy Independence Authority (proposed legislation)				42	
Storage, conservation, and resource development	520	1,256	1,272	2,558	3,469
Proposed legislation		−39	−39	−120	−120
Regulation	175	222	223	229	232
Research and development	1,690	2,677	2,677	3,383	3,343
Proposed legislation				3	3
Subtotal	2,385	4,115	4,133	6,094	6,926
Other natural resources	897	1,048	1,048	1,092	1,099
Deductions for offsetting receipts	−807	−800	−800	−997	−997
Total outlays	**11,282**	**17,050**	**17,139**	**19,747**	**20,504**

Proposed budget revisions in this function provide increased funding for environmental programs, and funds for upgrading national parks and wildlife refuges. Additional emphasis is placed on energy conservation programs, and development of petroleum storage reserves will be accelerated. Energy research and development will be reoriented to place more emphasis on technologies with nearer term impact.

Revised budget authority requests for this function are $17.7 billion in 1977 and $20.5 billion in 1978. These amounts represent increases of $3.4 billion for 1977 and $1.4 billion for 1978 over the January budget requests. Outlays are estimated to total $17.1 billion in 1977 and $20.5 billion in 1978—$0.1 billion and $0.8 billion higher, respectively, than the January figures.

Energy.—Budget revisions for energy emphasize energy conservation, petroleum storage, and decreased emphasis on long-term energy research and development, e.g., breeder reactors. The 1978 revised request increases budget authority $1.3 billion and outlays $0.8 billion over the January budget.

Proposed budget authority for energy conservation programs has been increased substantially over the January budget levels. These programs include initial funding for $2 billion in loan guarantees to encourage energy conservation measures; accelerated implementation of weatherization assistance to provide insulation for low-income persons; grants so States can inform interested homeowners about ways to save energy; and development of an experimental energy extension service. Also included are grants to States to establish offices to represent consumers before utility regulatory commissions, and additional funds for developing a program requiring major appliances to have energy cost and efficiency information on their labels. Budget authority for energy conservation is proposed to increase by $22 million in 1977 and $244 million in 1978 over the January budget request. In 1978, $160 million of the increase is for research and development, which includes funds to implement the Electric Vehicle Act.

The proposed acceleration in the petroleum storage program will provide earlier protection from possible future disruptions in world petroleum supplies. The revised budget requests an increase in 1978 of $1.3 billion in budget authority and $858 million in outlays. This will allow the Federal Energy Administration to attempt to store 250 million barrels of petroleum by December 1978, 100 million more than required by law and proposed in the January budget. It will also allow the Federal Energy Administration to store about 500 million barrels by December 1980, 2 years earlier than previously planned.

Proposed reductions in nuclear research and development efforts total $304 million in 1978. This includes a $199 million decrease in budget authority for the liquid metal fast breeder reactor, which will reduce the program below the 1977 level of $686 million, pending a reevaluation of the current program. It also includes an $80 million reduction in fusion energy research and development. Smaller reductions in uranium enrichment result primarily from engineering and construction delays. Budget authority for fossil energy research and development is proposed to increase $42 million in 1978 to demonstrate enhanced oil and gas recovery techniques and currently available coal conversion technologies.

Other revisions affecting energy programs include increases to maintain staffing levels for petroleum product pricing and allocation programs. Authorization is also being proposed to permit the Nuclear Regulatory Commission to fund qualified public intervenors in the pending rulemaking proceedings regarding the use of plutonium to fuel nuclear reactors.

No changes are proposed at this time in the overall level of funding for programs associated with the nuclear fuel cycle and nuclear nonproliferation pending the completion of the nonproliferation policy review now underway.

Natural resources and environment.—Budget authority of $5.2 billion for 1977 is proposed for sewage plant construction grants of the Environmental Protection Agency. Budget authority for 1978 will be requested after congressional action on pending program reform legislation has been completed. Proposed budget authority for grants to States for environmental control and for comprehensive areawide planning is increased by more than $80 million. Regulatory functions of the Environmental Protection Agency are proposed to be strengthened by the addition of 600 employees over the 1976 level.

Budget authority for water resources development projects is reduced by $268 million below the January budget request for 1978. The administration is reviewing projects that may be environmentally or economically unsound or potentially hazardous. Pending completion of review, 1978 appropriation requests for 18 projects are deleted from this budget. Proposals on water policy reform and recommendations as to the future course of affected projects, along with appropriate budget amendments, will be made on completion of this review.

Increased budget authority is recommended for the Youth Conservation Corps to restore the 1977 current services level of $30 million. This will permit the Federal Government to provide short-term employment opportunities on public lands for approximately 20,000 youths between the ages of 15 and 18. Increased budget authority is also recommended to restore the agricultural conservation program and the great plains conservation program to the 1977 current services level of $212 million. These programs will be reviewed during the coming year with the objective of improving their contribution to the conservation of our Nation's land and water resources.

The January budget request for an immediate lump-sum appropriation for a 10-year program to upgrade parks and wildlife refuges is being replaced with a program to provide a similar annual level of resources over a 5-year period. Thus, outlays for recreation, parks and wildlife programs are estimated to be $47 million above the January budget estimate for 1977 and $61 million higher for 1978.

350: Agriculture

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Farm income stabilization:					
Price-support and related programs	2,750	189	189	1,234	1,234
Long-term land retirement programs	42				
National Wool Act	27	47	47	12	12
Federal Crop Insurance Corporation	12	52	102	12	12
Agricultural credit insurance fund	169	141	141	165	165
Administrative expenses and other	158	161	161	164	164
Subtotal	3,158	591	641	1,588	1,588
Agricultural research and services:					
Research programs	406	420	420	465	465
Extension programs	229	241	241	242	242
Consumer protection, marketing and regulation	253	300	300	311	311
Economic intelligence	94	107	107	113	113
Other	57	60	60	61	61
Offsetting receipts	−48	−49	−49	−49	−49
Subtotal	991	1,079	1,079	1,144	1,144
Deductions for offsetting receipts	7	−2	−2	−3	−3
Total budget authority	4,157	1,668	1,718	2,729	2,729
OUTLAYS:					
Farm income stabilization:					
Price-support and related programs	1,014	1,820	1,820	864	864
Long-term land retirement programs	37	21	21		
National Wool Act	45	12	12	3	3
Sugar Act	10	*	*		
Federal Crop Insurance Corporation	15	74	74	19	19
Agricultural credit insurance fund	296	−314	−314	142	142
Administrative expenses and other	155	159	159	161	161
Subtotal	1,574	1,773	1,773	1,188	1,188
Agricultural research and services:					
Research programs	352	458	458	463	463
Extension programs	218	241	241	243	243
Consumer protection, marketing and regulation	256	310	310	316	316
Economic intelligence	91	108	108	114	114
Other	53	60	60	60	60
Offsetting receipts	−48	−49	−49	−49	−49
Subtotal	921	1,128	1,128	1,147	1,147
Deductions for offsetting receipts	7	−2	−2	−3	−3
Total outlays	2,502	2,899	2,899	2,333	2,333

The only change now proposed for agriculture programs is a $50 million increase in 1977 budget authority. Legislation will be proposed to raise the capital stock of the Federal Crop Insurance Corporation by $50 million. This will assure sufficient funds to cover possible crop losses that might occur due to continued poor weather.

Major elements of farm program legislation will expire this year, and the administration is preparing proposals for agriculture programs for transmittal to the Congress in March. No estimates of the cost of these proposals are available.

400: Commerce and Transportation

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Mortgage credit and thrift insurance:					
HUD—mortgage insurance and related programs	6,275	1,027	1,027	1,125	1,125
Agriculture—rural housing programs	138	192	192	328	335
Subtotal	6,413	1,219	1,219	1,453	1,460
Postal Service	1,708	2,272	2,272	1,472	1,696
Other advancement and regulation of commerce:					
Technology utilization	162	175	175	184	178
Economic and demographic statistics	93	113	113	136	136
Payroll tax credit (proposed legislation)	--------	--------	--------	--------	166
Small business assistance	318	632	692	603	603
Other	306	342	342	347	351
Subtotal	879	1,262	1,322	1,270	1,434
Ground transportation:					
Highway improvement and construction	5,050	3,667	3,667	6,993	7,052
Traffic and highway safety	124	91	91	236	236
Mass transit	1,046	571	571	492	492
Railroads	1,610	1,093	1,093	1,828	2,216
Proposed legislation	--------	−70	−70	−100	−275
Regulation	67	62	62	62	62
Subtotal	7,898	5,414	5,414	9,511	9,783
Air transportation:					
Airways and airports	1,948	2,588	2,588	2,736	2,736
Proposed legislation	--------	--------	--------	−3	−3
Air carrier subsidies	64	77	77	70	70
Aeronautical research and technology	325	379	379	423	423
Subtotal	2,337	3,043	3,043	3,226	3,226
Water transportation:					
Coast Guard	1,093	1,286	1,286	1,336	1,337
Proposed legislation	--------	--------	--------	−1	−1
Shipping	539	438	438	404	556
Subtotal	1,631	1,724	1,724	1,740	1,892
Other transportation	74	81	81	90	90
Deductions for offsetting receipts	−52	−43	−43	−67	−67
Total budget authority	20,890	14,974	15,034	18,694	19,514

400: COMMERCE AND TRANSPORTATION (in millions of dollars)—Con.

Subfunction and major program	1976 actual budget	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
OUTLAYS:					
Mortgage credit and thrift insurance:					
HUD—mortgage insurance and related programs	1,799	647	647	635	635
Agriculture—rural housing programs	7	−429	−429	415	416
Federal Deposit Insurance Corporation	−478	−861	−861	−379	−379
Federal Home Loan Bank Board and other	−99	−1,447	−1,826	−455	−431
Subtotal	1,229	−2,090	−2,469	217	241
Postal Service	1,720	2,272	2,272	1,472	1,696
Other advancement and regulation of commerce:					
Technology utilization	166	181	181	183	178
Economic and demographic statistics	86	113	113	130	130
Payroll tax credit (proposed legislation)	--------	--------	--------	--------	166
Small business assistance	307	393	435	430	448
Other	308	349	349	350	354
Subtotal	867	1,036	1,078	1,094	1,276
Ground transportation:					
Highway improvement and construction	6,477	6,069	6,069	7,162	7,324
Traffic and highway safety	151	182	182	224	224
Mass transit	1,492	2,146	2,146	2,404	2,414
Proposed legislation	--------	--------	--------	−100	−60
Railroads	1,132	1,661	1,661	1,545	1,718
Regulation	52	61	61	63	63
Subtotal	9,305	10,119	10,119	11,298	11,683
Air transportation:					
Airways and airports	2,153	2,417	2,417	2,732	2,747
Proposed legislation	--------	--------	--------	−3	−3
Air carrier subsidies	71	77	77	69	69
Aeronautical research and technology	333	349	349	392	392
Subtotal	2,557	2,843	2,843	3,190	3,205
Water transportation:					
Coast Guard	1,007	1,203	1,203	1,331	1,332
Proposed legislation	--------	--------	--------	−1	−1
Shipping	551	682	682	634	645
Subtotal	1,558	1,885	1,885	1,964	1,976
Other transportation	65	83	83	85	85
Deductions for offsetting receipts	−52	−43	−43	−67	−67
Total outlays	17,248	16,106	15,769	19,252	20,093

Outlays for commerce and transportation programs are now estimated to be $15.8 billion in 1977 and $20.1 billion in 1978. These amounts are $0.3 billion lower and $0.8 billion higher than the January budget estimates for 1977 and 1978, respectively.

Transportation.—Major increases to the January budget are proposed for transportation programs. Outlays for highway improvement and construction are estimated to be $162 million above the January budget estimates for 1978. The revised 1978 highway obligation level includes $7.5 billion for Federal-aid highways and off-system railway-highway crossings. This new obligation level is $1.0 billion above the January budget request for 1978 and essentially reflects the levels enacted for 1976 and 1977. The 1978 funding level for the off-system railway-highway crossing program is increased by $50 million.

The revised budget requests an additional $50 million in outlays for mass transit programs in 1978. The revised budget does not request the mandatory ceiling on formula grant operating subsidies that was included in the January budget. This increases the amounts available for transit operating subsidies. In addition, an increase of $100 million in the obligation ceiling is provided to expand grants for bus purchases and rail transit improvements by local jurisdictions in 1978.

Outlays for Federal assistance to the railroads are estimated to increase by $173 million over the January budget estimate for 1978. Of this increase, $135 million is for the purchase of redeemable preference shares, a form of nonvoting preferred stock that the Government can buy from the railroads. In addition to this increase, the policy of placing highest priority on mergers and consolidations for use of funds from these shares is also being modified. The Department of Transportation is in the process of developing a new policy for use of the redeemable preference shares. Outlays for aid to Amtrak are increased by $38 million from the January budget for 1978. This increase lowers the possibility of sharp reductions of service and provides a higher level of capital investment than assumed in the January budget estimates.

Outlays for air transportation are estimated to be $15 million above the January budget estimate for 1978 as a result of a $75 million increase in discretionary contract authority for grants-in-aid to airports.

Outlays for water transportation have been increased to enhance the Cost Guard's capability to help prevent tanker accidents and related oilspills; and to provide an additional $11 million in outlays and $152 million in budget authority for U.S.-flag ship operating and construction subsidies. In addition, a task force has been established to review measures to reduce the potential for oilspills.

Housing and mortgage credit.—The 1978 estimates for agricultural housing programs reflect the restoration of farm labor housing grants to the 1977 enacted level.

Budget outlays for the Federal Home Loan Bank Board are estimated to be $379 million below the January estimates for 1977. This reflects the repayment of the loan made to the Federal Home Loan Mortgage Corporation in 1975 to finance the forward commitment program. Prepayment of the loan, which is due in 2005, was not anticipated in the January budget. As a result, 1978 outlays are estimated to be $23 million higher, reflecting lower offsetting receipts.

Aids to business.—As part of the economic stimulus package, the budget reflects legislation to allow businesses to take a credit against income taxes equal to 4% of payroll taxes paid for social security (FICA) and 2% of railroad retirement and self-employment taxes. Payments in excess of tax liability are treated as outlays. Such payments in 1978 are estimated at $166 million.

The proposed rescission in the January budget to reduce the Small Business Administration's 7(a) regular business direct loan program by $60 million is being withdrawn. The outlay estimates for 1977 and 1978 reflect the full commitment of these loan funds in 1977.

Postal Service.—Proposed payments to the Postal Service fund for 1978 amount to $1.7 billion, an increase of $223 million over the January budget request. This increase reflects a decision to provide funds to cover the cost of the extended phasing in of full cost recovery of mail rates for certain second, third, and fourth class mail users.

450: Community and Regional Development

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
BUDGET AUTHORITY:					
Community development:					
Dept. of Housing and Urban Development:					
Community development block grants	1,838	3,448	3,248	3,500	4,000
Expiring categorical programs	2	3	3	13	13
Research and planning	128	118	118	85	122
Other community development	778	291	291	214	218
Dept. of Agric.: Water and sewer grants	250	200	200	50	200
District of Columbia	211	102	102	161	161
ACTION	103	109	109	95	117
Community Services Administration	520	512	512	398	442
Pennsylvania Avenue Development	1	30	30	21	21
Other	11	20	20	16	16
Subtotal	3,842	4,833	4,633	4,554	5,311
Area and regional development:					
Department of Agriculture	318	365	365	352	352
Department of Commerce:					
Local public works	--------	2,000	4,000	3	2,000
Coastal energy impact	--------	110	110	143	143
Other	514	490	490	317	440
Indian programs	637	736	736	778	778
Appalachian programs	316	124	124	304	304
Other programs	1	1	1	1	1
Offsetting receipts	−239	−277	−277	−277	−277
Subtotal	1,546	3,548	5,548	1,622	3,742
Disaster relief and insurance:					
Dept. of Housing and Urban Development: Flood insurance and other	75	82	82	118	118
Disaster relief	150	200	300	150	150
Small Business Administration disaster loans	100	90	90	20	20
Department of Agriculture	10	10	10	10	10
Subtotal	335	383	483	298	298
Deductions for offsetting receipts	−15	−33	−33	−39	−39
Total budget authority	5,708	8,731	10,631	6,434	9,312

(in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
OUTLAYS:					
Community development:					
Dept. of Housing and Urban Development:					
Community development block grants	983	2,262	2,250	3,112	3,052
Expiring categorical programs	1,451	1,169	1,169	691	703
Research and planning	148	159	159	123	130
Other community development	159	279	285	218	265
Dept. of Agric.: Water and sewer grants	75	163	163	199	214
District of Columbia	116	176	176	176	176
ACTION	108	110	110	97	115
Community Services Administration	462	528	528	448	493
Pennsylvania Avenue Development	1	24	24	26	26
Other	24	22	22	22	22
Subtotal	3,527	4,892	4,887	5,112	5,195
Area and regional development:					
Department of Agriculture	238	247	247	301	301
Department of Commerce:					
Local public works	--------	800	1,000	803	2,800
Coastal energy impact	--------	51	51	80	80
Other	378	396	396	386	414
Indian programs	564	687	687	712	712
Appalachian programs	325	334	334	332	332
Other programs	1	1	1	1	1
Offsetting receipts	−239	−277	−277	−277	−277
Subtotal	1,266	2,240	2,440	2,339	4,364
Disaster relief and insurance:					
Dept. of Housing and Urban Development: Flood insurance and other	90	173	173	211	211
Disaster relief	291	300	400	150	150
Small Business Administration disaster loans	129	108	108	81	81
Department of Agriculture	11	15	15	15	15
Subtotal	522	596	696	457	457
Deductions for offsetting receipts	−15	−33	−33	−39	−39
Total outlays	5,300	7,695	7,989	7,868	9,976

The budget revisions for community and regional development programs reflect the administration's economic stimulus efforts, the restoration of budget cuts, aid to hard-pressed State and local governments, and increases for high-priority items not proposed in the January budget. These revisions increase budget authority by $1.9 billion to $10.6 billion in 1977 and by $2.9 billion to $9.3 billion in 1978 over levels sought in the January budget. Most of these increases are for grants to States and localities. Outlay estimates reflect the rate at which recipient governments are expected to draw down funds, and increase by $0.3 billion in 1977 and $2.1 billion in 1978.

The administration's economic stimulus program calls for a major increase in funding to States and local governments for the local public works program administered by the Economic Development Administration. Additional budget authority of $4.0 billion—$2.0 billion for both 1977 and 1978—supplements the $2.0 billion previously appropriated for 1977. Outlays resulting from this additional budget authority are estimated to be $200 million in 1977 and $2.0 billion in 1978.

The restoration of budget cuts for the Economic Development Administration increases budget authority by $101 million in 1978 and outlays by $5 million.

The administration's proposed increase of $500 million in budget authority for 1978 in the community development block grant program represents a major new initiative. Of this increase, $400 million is to fund a new urban development action grant that targets funds to distressed localities for specific community development programs aimed at neighborhood preservation and economic revitalization.

The restoration of budget cuts increases budget authority for other community development programs by $257 million in 1978. This includes $150 million for water and sewer programs in the Department of Agriculture, $21 million for ACTION, and $44 million for the Community Services Administration. The increase for the Community Services Administration primarily restores funding for the senior opportunities and services program, community food and nutrition program, and State economic opportunity offices.

500: Education, Training, Employment, and Social Services

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Elementary, secondary, and vocational education:					
Financial Assistance Act (proposed legislation)[1]				3,776	
Aid to education agencies	4,587	5,686	5,686	4,763	5,271
Proposed legislation[1]				−3,621	
Child development	502	524	524	525	537
Subtotal	5,089	6,209	6,209	5,443	5,808
Higher education:					
Student aid and institutional support	3,561	2,842	3,267	2,657	3,589
Special institutions	119	143	143	160	160
Subtotal	3,680	2,985	3,409	2,816	3,749
Research and general education aids:					
Educational research	91	113	113	135	138
Cultural activities	359	468	468	522	524
Other	316	544	553	571	598
Proposed legislation[1]				−154	
Subtotal	765	1,125	1,134	1,074	1,260
Training and employment:					
Public service employment	3,225	2,784	3,703	400	5,871
General training and employment program activities	2,671	3,074	4,581	2,838	4,256
Work incentive program	400	370	370	365	365
Proposed legislation				−21	
Job opportunities program	374				
Federal-State employment service	594	636	636	693	693
Subtotal	7,264	6,864	9,290	4,275	11,186
Other labor services	329	383	386	420	426
Social services:					
Grants to States for social services	2,833	2,730	2,730	2,542	2,542
Proposed legislation					200
Allied Services (proposed legislation)		20	20	20	20
Other social services	1,262	1,450	1,450	1,456	1,495
Proposed legislation[2]				−73	
Subtotal	4,095	4,200	4,200	3,945	4,257
Deductions for offsetting receipts	−5	−5	−5	−6	−6
Total budget authority	21,217	21,762	24,624	17,967	26,679

See footnotes at end of table.

(in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
OUTLAYS:					
Elementary, secondary, and vocational education:					
Financial Assistance Act (proposed legislation) [1]	--------	--------	--------	336	--------
Aid to education agencies	4,190	4,712	4,712	4,955	4,994
Proposed legislation [1]	--------	--------	--------	−322	--------
Child development	500	513	513	525	532
Subtotal	4,690	5,225	5,225	5,494	5,526
Higher education:					
Student aid and institutional support	2,537	3,283	3,322	2,768	3,209
Special institutions	126	152	152	166	166
Subtotal	2,663	3,434	3,474	2,934	3,375
Research and general education aids:					
Educational research	80	111	111	118	119
Cultural activities	332	529	529	577	578
Other	362	460	460	512	526
Proposed legislation [1]	--------	--------	--------	−14	--------
Subtotal	774	1,100	1,100	1,193	1,223
Training and employment:					
Public service employment	2,431	2,758	3,473	1,400	5,888
General training and employment program activities	2,732	2,955	3,283	2,912	4,747
Work incentive program	307	365	365	365	365
Proposed legislation	--------	--------	--------	−21	--------
Job opportunities program	269	129	129	--------	--------
Federal-State employment service	547	636	636	693	693
Subtotal	6,288	6,842	7,886	5,349	11,693
Other labor services	301	380	382	415	421
Social services:					
Grants to States for social services	2,258	2,730	2,730	2,542	2,542
Proposed legislation	--------	--------	--------	--------	200
Allied services (proposed legislation)	--------	5	5	20	20
Other social services	1,197	1,402	1,402	1,464	1,479
Proposed legislation [2]	--------	--------	--------	−48	--------
Subtotal	3,456	4,138	4,138	3,977	4,241
Deductions for offsetting receipts	−5	−5	−5	−6	−6
Total outlays	18,167	21,114	22,199	19,358	26,473

[1] Financial Assistance for Elementary and Secondary Education Act.
[2] Financial Assistance for Health Care Act.

The revised budget calls for substantial increases in these programs to assist individuals to become self-supporting members of society and to promote the general extension of skills and knowledge. Outlays for this function are now expected to be $22.2 billion in 1977 and $26.5 billion in 1978. Outlays are $1.1 billion higher in 1977 and $7.1 billion higher in 1978 than the January budget requests.

Employment and training.—The largest outlay increases in this function over the January budget level are $1.0 billion in 1977 and $6.3 billion in 1978 for employment and training, for which total outlays are now estimated to reach $7.9 billion in 1977 and $11.7 billion in 1978.

As part of the economic stimulus package, these programs will be temporarily expanded to help unemployed workers who will find it difficult to find a job even as the private economy expands. The number of federally funded public service jobs is proposed to increase from the current level of 310,000 to 600,000 by the end of 1977 and 725,000 during 1978. These changes increase the January outlay estimates for public service jobs by $715 million for 1977 and $4.5 billion for 1978. Outlays for other training and employment programs will be expanded by $328 million in 1977 and $1.6 billion in 1978 to provide skills and work opportunities for those of the unemployed who most need help, including youth and Vietnam-era veterans. Other 1978 outlay increases of $0.2 billion will restore programs to the 1977 level.

Education.—The budget also requests substantial additions for education programs of $1.5 billion in budget authority for 1978, bringing the total request to $10.8 billion. Outlays for education are now estimated to total $10.1 billion in 1978, $503 million above the January estimate. The revised budget does not propose consolidation of education programs into a block grant.

Budget authority for elementary, secondary, and vocational education, for 1978 is increased by $365 million. The revised request for elementary and secondary education emphasizes increased assistance to the disadvantaged and the handicapped, including an additional $350 million in 1978 budget authority for Title I of the Elementary and Secondary Education Act, which provides services for the education of the disadvantaged. The budget revisions also increase the requests for bilingual education, emergency school aid, and education of the handicapped.

The revised budget supports reform of the impact aid program as previously recommended. This would limit Federal aid to those districts where Federal activities impose a real economic burden on school systems.

For higher education, budget authority increases of $424 million in 1977 and $933 million in 1978 are requested. The resulting outlay increases are $39 million and $441 million for the 2 years respectively. The revised request includes additional budget authority of $472 million in 1978 for the basic opportunity grant program in order to increase the maximum award from $1,400 to $1,600. This would help an additional 500,000 undergraduates attend college. An additional $140 million for budget authority for work-study is also provided in order to increase the number of student jobs by more than 30,000.

Social services.—Budget authority and outlays for grants to States for social services are increased by $200 million over the January estimates for 1978 to provide for child day care services under Title XX of the Social Security Act. Added resources are also proposed for aging programs to improve the provision of rehabilitation services to the disabled, to study problems in youth development, and to hold a White House Conference on the Family.

550: Health

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate: January budget	1977 estimate: Revised budget	1978 estimate: January budget	1978 estimate: Revised budget
BUDGET AUTHORITY:					
Health care services:					
Medicare	18,524	22,993	22,960	28,659	28,674
Cost control (proposed legislation)		5		−76	−10
Other (proposed legislation)			−39		36
Medicaid	8,510	10,229	10,229	11,816	11,816
Cost control (proposed legislation)					−134
Child health (proposed legislation)					180
Other (proposed legislation) [1]				−11,816	
Other health care services	2,179	2,485	2,491	2,312	2,639
Proposed legislation [1]				−1,162	
Subtotal	29,214	35,712	35,641	29,733	43,201
Health research and education	2,981	3,188	3,209	2,439	3,148
Prevention and control of health problems:					
Existing law	1,087	1,069	1,070	951	1,117
Proposed legislation [1]				−79	
Subtotal	1,087	1,069	1,070	871	1,117
Health planning and construction:					
Existing law	376	393	395	1,365	388
Proposed legislation [1]				−157	
Subtotal	376	393	395	1,208	388
General health financing assistance:					
Proposed legislation [1]				13,172	
Deductions for offsetting receipts	−8	−8	−8	−8	−8
Total budget authority	33,649	40,354	40,307	47,416	47,847
OUTLAYS:					
Health care services:					
Medicare	17,779	21,991	21,991	26,081	26,081
Cost control (proposed legislation)		−218		−1,784	−695
Other (proposed legislation)			5		25
Medicaid	8,568	10,229	10,229	11,816	11,816
Cost control (proposed legislation)					−134
Child health (proposed legislation)					180
Other (proposed legislation) [1]				−11,816	
Other health care services	2,308	2,451	2,457	2,187	2,448
Proposed legislation [1]				−463	
Subtotal	28,655	34,454	34,682	26,020	39,721
Health research and education	3,086	2,762	2,784	2,623	3,150
Prevention and control of health problems:					
Existing law	963	1,096	1,098	971	1,117
Proposed legislation [1]				−26	
Subtotal	963	1,096	1,098	945	1,117

See footnote at end of table.

550: HEALTH (in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
OUTLAYS—Continued					
Health planning and construction:					
Existing law	752	947	949	1,386	505
Proposed legislation [1]				−64	
Subtotal	752	947	949	1,322	505
General health financing assistance:					
Proposed legislation [1]				12,302	
Deductions for offsetting receipts	−8	−8	−8	−8	−8
Total outlays	33,448	39,251	39,505	43,205	44,485

[1] Financial Assistance for Health Care Act.

Major new health initiatives proposed in the revised 1978 budget include a nationwide program to hold down the rate of inflation in hospital costs and an $180 million program of improvements in comprehensive health care for children in low-income families under medicaid. In addition, a new program of $6 million in budget authority is being proposed to provide immunizations, particularly for disadvantaged children in rural areas. Other proposed increases in 1978 budget authority include $147 million for training health personnel, $49 million for health services, and $13 million for health research. The revised 1978 budget does not propose consolidation of medicaid and other categorical health programs into a health block grant. Consolidated funding for biomedical research and for health agencies' salaries and expenses accounts is also not proposed in the revised 1978 budget. Thus, the bulk of the budget authority increases of $328 million in other health care services, $709 million in health research and education, $166 million in disease prevention, as well as the decrease of $977 million in health planning, reflects the reallocation of agencies salaries and expenses back into the individual health agency accounts.

Outlays for health are now estimated to total $39.5 billion in 1977 and $44.5 billion in 1978. These amounts are $254 million and $1.3 billion above the respective estimates in the January budget. Revisions in medicare proposals account for $1.1 billion of the change in 1978 outlays.

Medicare and medicaid.—National health spending per person has more than tripled during the last decade, from $212 in 1966 to $638 in 1976. Total national health expenditures grew from $42.1 billion to $139.3 billion during the same period. The availability and use of new medical services account in part for rising spending. Nevertheless, much of the increase has resulted from health cost inflation. Without cost restraints, Federal spending for medicare and medicaid alone would climb 75% between 1978 and 1982, from $38 billion to $66 billion.

To curb further health inflation, the revised 1978 budget reflects proposed legislation to allow the Federal Government to limit increases in reimbursements to hospitals paid by medicare, medicaid, State and local governments, insurance companies, and private individuals. Assuming a 9% limit on such increases and up to 1% for exceptions, the proposal would result in outlays savings of $695 million for medicare, $134 million for medicaid, and $1.6 billion for other payors in 1978. The Secretary of Health, Education, and Welfare would establish the precise limits after consultation with the States, health and insurance industries, purchasers, and consumers of health services.

Another major initiative would improve medicaid by establishing a new program to screen all children from low-income families for medical problems and, when necessary to provide followup treatment. The number of eligible children would be increased from about 12 million to about 14 million. A 75% Federal match is designed to give those States currently receiving Federal matching payments below 75% a greater incentive to undertake the new program.

The revised 1978 budget also proposes medicare program improvements to benefit 26 million medicare beneficiaries. The monthly premium for supplementary medical insurance for physician and other outpatient services would remain at $7.20 through September 1978 rather than being increased to

$7.70 on July 1, 1977 and to an estimated $8.10 on July 1, 1978. In the future, premiums for supplementary medical insurance would be adjusted effective October 1. This would reduce previous estimates of payments by the elderly for medicare premiums by $37 million in 1977 and $182 million in 1978. Federal payments of the same amounts in 1977 and 1978 from general revenues will make up for reduced premium payments by the elderly. Proposed medicare legislation, with estimated outlays of $25 million in 1978, would promote the availability of primary and rural health care by extending cost reimbursement to nurse practitioners and physician assistants practicing in rural health clinics.

Health research and education.—An additional $101 million in 1978 budget authority is requested for health professions education training programs. The revised budget request would provide a total of $307 million in budget authority primarily for the Health Professions Education Assistance Act of 1976. This will allow Federal capitation grants of $1,350 for each medical, osteopathic, and dental student, an increase of $5 million for a total of $40 million in budget authority for service commitment scholarships, and $106 million in budget authority for special project grants and contracts. These programs are designed to improve geographic and specialty distribution of physicians and dentists.

An increase of $46 million in budget authority for mental health, alcohol, and drug abuse training activities is requested to support training programs in institutions, as well as research, demonstration, and technical assistance to the States.

Other health initiatives.—An increase of $35 million in budget authority is requested in 1978 to provide further alternatives to abortion through expanded Federal support for family planning, community health centers, sex education, population research, and foster child care research and demonstrations.

600: Income Security

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
General retirement and disability insurance:					
Social security (OASDI)	69,444	79,686	79,509	87,221	87,327
Proposed legislation	--------	--------	--------	1,374	65
Railroad retirement	3,235	3,664	3,664	3,907	3,907
Proposed legislation	--------	--------	--------	12	--------
Special benefits for disabled coal miners	1,022	992	992	995	995
$50 payments to certain social insurance recipients (proposed legislation)	--------	--------	1,810	--------	--------
Other	4	4	4	4	4
Subtotal	73,705	84,345	85,978	93,513	92,298
Federal employee retirement and disability	13,470	16,916	16,916	16,888	16,888
Unemployment insurance	13,233	17,162	16,513	15,961	15,060
Public assistance and other income supplements:					
Supplemental security income	5,529	5,895	5,895	5,750	5,750
AFDC and other	5,898	6,306	6,306	6,606	6,606
Proposed legislation	--------	--------	--------	−63	−50
Housing assistance	19,405	15,517	31,067	24,598	33,536
Food stamps	5,196	4,786	5,506	5,627	5,627
Proposed legislation	--------	--------	--------	−882	--------
School lunch and other nutrition programs	2,540	3,369	3,369	2,742	2,973
Proposed legislation	--------	--------	--------	−787	--------
Earned income credit payments	808	856	856	835	835
Proposed legislation	--------	--------	--------	−835	70
$50 payments to certain individuals (proposed legislation)	--------	--------	1,363	--------	--------
Refugee assistance	85	132	132	58	68
Other	151	156	183	176	183
Subtotal	39,613	37,017	54,678	43,825	55,597
Deductions for offsetting receipts	−1	−*	−*	−*	−*
Total budget authority	140,019	155,440	174,085	170,186	179,843
OUTLAYS:					
General retirement and disability insurance:					
Social security (OASDI)	72,664	83,393	83,393	91,795	91,795
Proposed legislation	--------	−43	−35	−998	−777
Railroad retirement	3,475	3,727	3,727	3,896	3,896
Special benefits for disabled coal miners	1,012	982	982	993	993
$50 payments to certain social insurance recipients (proposed legislation)	--------	--------	1,810	--------	--------
Other	21	3	3	4	4
Subtotal	77,173	88,062	89,880	95,689	95,910
Federal employee retirement and disability	8,174	9,662	9,662	11,094	11,094

600: INCOME SECURITY (in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
OUTLAYS—Contiued					
Unemployment insurance:					
Existing law	19,452	16,380	15,370	13,861	12,710
Proposed extension of Federal supplemental benefits	--------	--------	500	--------	400
Subtotal	19,452	16,380	15,870	13,861	13,110
Public assistance and other income supplements:					
Supplemental security income	5,060	5,369	5,369	5,714	5,714
AFDC and other	5,849	6,306	6,306	6,606	6,606
Proposed legislation	--------	--------	--------	−63	−50
Housing assistance	2,493	2,952	2,989	3,711	3,841
Food stamps	5,632	4,754	5,474	5,594	5,594
Proposed legislation	--------	--------	--------	−882	--------
School lunch and other nutrition programs	2,327	3,385	3,385	3,328	3,559
Proposed legislation	--------	--------	--------	−1,012	--------
Earned income credit payments	808	856	856	835	835
Proposed legislation	--------	--------	--------	−835	70
$50 payments to certain individuals (proposed legislation)	--------	--------	1,363	--------	--------
Refugee assistance	343	225	225	78	87
Other	96	166	193	174	180
Subtotal	22,609	24,014	26,161	23,249	26,435
Deductions for offsetting receipts	−1	−*	−*	−*	−*
Total outlays	**127,406**	**138,118**	**141,573**	**143,892**	**146,549**

*$50,000 or less.

The revised budget proposals for income security programs reflect:

—the administration's proposed cash payments that are part of the economic stimulus package;

—revisions in the social security reforms proposed in the January budget and withdrawal of the proposed increase in social security tax rates beyond that provided for in existing law;

—extension of Federal supplemental unemployment benefits in modified form;

—withdrawal of the child nutrition block grant and food stamp proposals in the January budget that would have reduced outlays;

—significantly increased funding for housing assistance;
—withdrawal of the proposal to repeal the earned income credit in 1978; and
—phaseout of the Cuban refugee program.

The changes proposed for income security programs increase outlays by $4.5 billion in 1977 and $3.8 billion in 1978. These increases are partly offset by downward re-estimates in unemployment benefits under existing law, which are now expected to be $1.0 billion below the January estimates for 1977 and $1.2 billion lower in 1978.

Stimulus proposals.—Outlays in 1977 are increased $3.2 billion by the President's economic stimulus proposal to make $50 payments to:

—social security, supplemental security income, and railroad retirement recipients ($1.8 billion); and
—recipients of the earned income credit and certain other persons with earned income but limited tax liability ($1.4 billion).

Social security.—The January budget included a variety of social security proposals. The proposed change to correct certain technical deficiencies in the adjustment of social security benefits is being deferred pending further study. The January budget proposal to phase out student benefits will be modified so that student beneficiaries will receive the same amount that the maximum basic education opportunity grant provides. Most students would be qualified for such a grant if they were to be denied benefits under social security. Other social security benefit proposals in the January budget are retained. Increases in outlays stemming from these changes to the budget are $221 million in 1978. The social security tax rate increase requested in the January budget has been withdrawn. This decreases budget authority by $1.3 billion in 1978 below the January levels. Proposals to solve the social security financing problem are being carefully reviewed by this administration, and recommendations to the Congress will be submitted shortly.

Unemployment benefits.—The Federal supplemental unemployment benefits program, which currently pays up to 26 additional weeks of benefits to unemployment insurance claimants in high unemployment States, expires on March 31, 1977. The budget proposes to extend the program in modified form through March 31, 1978, including a 3-month phaseout. During the extension, Federal supplemental benefits of up to 13 weeks will be paid in States with high unemployment, resulting in a maximum of 52 weeks of benefits to the unemployed. This proposal increases outlays by $500 million in 1977 and $400 million in 1978.

Food programs.—A large portion of the increase in income security outlays reflects the restoration of funds for the food stamp and child nutrition programs due to the withdrawal of proposals contained in the January budget. Resulting outlay increases for food stamps are estimated at $0.7 billion in 1977 and $0.9 billion in 1978. An outlay increase of $1.2 billion is estimated for child nutrition programs in 1978. The administration will be reviewing alternative proposals for the food stamp program, as well as child nutrition and school lunch programs.

Housing assistance.—The revised budget also proposes a number of significant changes for housing assistance. The number of additional subsidized housing units to be assisted in 1977 will be increased from 235,800 to 400,000, requiring an increase of $9.6 billion in budget authority for 1977. As a result outlays will increase $70 million in 1978. In addition, legislation will be proposed to allow an increase from 20 years to 30 years in the subsidy contract terms for newly constructed subsidized housing that is not federally insured or financed. This should encourage greater involvement by private sector lenders in the financing of subsidized housing and will require additional budget authority of $4.9 billion in 1977, and $5.7 billion in 1978. Additional budget authority of $940 million in 1977 and 1978 is also proposed for subsidized units developed by State housing agencies. In 1978, 50,000 of the

400,000 units planned for approval will be set aside for traditional low-income public housing, requiring an additional $1.6 billion of budget authority.

Outlays for public housing operating subsidies will be increased $10 million in 1977 and $17 million in 1978 to reflect higher utility costs stemming from the severe winter weather of 1977. In addition, 1978 outlays will be increased another $14 million to avoid increasing rents for public housing tenants and to provide adequate funding to offset anticipated operating cost increases.

The budget restores very low-income housing repair grants administered by the Department of Agriculture to the 1977 enacted level.

Other changes—The proposal in the January budget to abolish the earned income credit program is withdrawn, thus increasing 1978 outlays by $835 million from the January budget estimate. In addition, earned income credit outlays are increased by $70 million in 1978 due to the proposed economic stimulus proposal to increase the standard deduction for low- and middle-income taxpayers.

The January budget included a legislative proposal to gradually reduce the matching rate for State administrative costs under the child support enforcement program. This proposal is withdrawn, increasing 1978 budget authority and outlays for the program of aid to families with dependent children (AFDC) by $13 million. Budget authority will be increased over the January budget level for the Cuban refugee program by $10 million in 1978 to assist a gradual phaseout of that program, to be completed by 1981.

700: Veterans Benefits and Services

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Income security for veterans:					
Veterans compensation and pension	8,083	8,806	8,806	8,928	8,928
Proposed legislation					408
Other veterans income security	166	176	176	189	189
Proposed legislation				−80	−80
National service life insurance trust fund	852	927	927	993	993
U.S. Government life insurance trust fund	38	37	37	38	38
All other insurance programs	7	7	7	2	2
Insurance program receipts	−460	−500	−500	−523	−523
Subtotal	8,685	9,454	9,454	9,548	9,956
Veterans education, training, and rehabilitation:					
Existing law	6,015	3,984	3,984	3,245	3,245
Proposed legislation				−525	−69
Subtotal	6,015	3,984	3,984	2,720	3,176
Hospital and medical care for veterans:					
Medical care and hospital services	3,854	4,406	4,406	4,736	4,736
Proposed legislation		−19	−19	−158	−158
Construction	414	508	508	536	536
Proposed legislation				5	5
Medical administration, research and other	168	182	182	200	200
Subtotal	4,436	5,077	5,077	5,319	5,319
Other veterans benefits and services:					
VA administrative expenses and other	517	534	534	583	583
Proposed legislation				4	4
Non-VA support program	27	27	27	27	27
Subtotal	544	561	561	614	614
Deductions for offsetting receipts	−2	−2	−2	−2	−2
Total budget authority	19,678	19,073	19,073	18,199	19,062

700: VETERANS BENEFITS AND SERVICES (in millions of dollars)—Continued

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
OUTLAYS:					
Income security for veterans:					
Veterans compensation and pension	8,014	8,805	8,805	8,922	8,922
Proposed legislation					408
Other veterans income security	165	178	178	187	187
Proposed legislation				−80	−80
National service life insurance trust fund	633	630	630	690	690
U.S. Government life insurance trust fund	71	66	66	70	70
All other insurance programs	−72	−72	−72	−71	−71
Insurance program receipts	−460	−500	−500	−523	−523
Subtotal	8,350	9,107	9,107	9,195	9,603
Veterans education, training, and rehabilitation:					
Existing law	5,531	4,138	4,138	3,812	3,812
Proposed legislation				−484	−28
Subtotal	5,531	4,138	4,138	3,328	3,783
Hospital and medical care for veterans:					
Medical care and hospital services	3,695	4,383	4,383	4,724	4,724
Proposed legislation		−19	−19	−158	−158
Construction	197	303	303	361	361
Proposed legislation				2	2
Medical administration, research and other	154	184	184	205	205
Subtotal	4,046	4,851	4,851	5,135	5,135
Veterans housing:					
Loan guaranty revolving fund	−22	−32	−32	85	85
Direct loan revolving fund	−43	−231	−231	−57	−57
HUD PC sales trust fund	−7	−8	−8	−7	−7
Subtotal	−72	−271	−271	21	21
Other veterans benefits and services:					
VA administrative expenses and other	554	540	540	573	573
Proposed legislation				3	3
Non-VA support programs	24	26	26	27	27
Subtotal	578	565	565	603	603
Deductions for offsetting receipts	−2	−2	−2	−2	−2
Total outlays	18,432	18,388	18,388	18,279	19,143

The revised budget request for veterans benefits and services reflects two changes from the January budget: (1) the addition of proposed cost-of-living increases in 1978 compensation and pension benefits, and (2) withdrawal of the proposal to limit the period of eligibility for GI bill education benefits. As a result, budget authority and outlays in 1978 are now estimated to be $19.1 billion, $0.9 billion above the January estimate. The 1977 estimates are not affected by these revisions.

The administration will propose legislation to increase 1978 benefits based upon the anticipated percentage increase in the CPI, effective October 1, 1977 for compensation benefits, and January 1, 1978 for pensions. The proposed increases raise the January budget estimate of 1978 outlays for compensation and pension benefits by $408 million.

The January budget recommended legislation to return the period of eligibility for GI bill education benefits to 8 years following discharge from military service. The eligibility period had been extended to 10 years in 1974. The revised budget withdraws support for the proposed legislation, resulting in an increase in outlays for readjustment benefits of $456 million in 1978.

750: Law Enforcement and Justice

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate		1978 estimate	
		January budget	Revised budget	January budget	Revised budget
BUDGET AUTHORITY:					
Federal law enforcement and prosecution:					
Litigation:					
Justice Department	252	294	294	309	310
Legal Services Corporation and other [1]	111	146	146	115	200
Enforcement:					
Federal Bureau of Investigation	486	513	513	529	529
Drug Enforcement Administration	155	168	168	181	182
Bureau of Alcohol, Tobacco and Firearms	110	119	119	137	125
Customs Service	329	359	359	383	383
Immigration and Naturalization Service	215	245	245	254	256
Secret Service	118	122	122	130	130
Other enforcement	145	159	161	171	178
Subtotal	1,920	2,125	2,127	2,209	2,292
Federal judicial activities	331	377	377	423	423
Federal correctional and rehabilitative activities	240	329	329	336	337
Law enforcement assistance	810	759	759	714	714
Deductions for offsetting receipts	−4	−6	−6	−6	−6
Total budget authority	3,297	3,584	3,586	3,677	3,760
OUTLAYS:					
Federal law enforcement and prosecution:					
Litigation:					
Justice Department	249	289	289	304	305
Legal Services Corporation and other	105	147	147	115	200
Enforcement:					
Federal Bureau of Investigation	469	515	515	529	529
Drug Enforcement Administration	146	176	176	184	184
Bureau of Alcohol, Tobacco and Firearms	103	122	122	135	124
Customs Service	334	358	358	383	383
Immigration and Naturalization Service	201	242	242	253	254
Secret Service	105	121	121	128	128
Other enforcement	140	165	166	187	193
Subtotal	1,852	2,134	2,135	2,219	2,301
Federal judicial activities	313	387	387	423	423
Federal correctional and rehabilitative activities	238	290	290	327	327
Law enforcement assistance	921	907	899	827	817
Deductions for offsetting receipts	−4	−6	−6	−6	−6
Total outlays	3,320	3,712	3,705	3,789	3,862

[1] In accordance with the Legal Services Corporation Act of 1974, the Corporation will directly request to the Congress $217 million in 1978.

The revised budget requests for law enforcement and justice programs reflect increases for legal aid, juvenile delinquency programs and civil rights, partly offset by decreases in lower priority programs. For 1978, outlays are now estimated at $3.9 billion, $73 million above the January budget.

A reallocation of resources for the Law Enforcement Assistance Administration is requested to provide additional funds for juvenile justice and delinquency prevention programs that have a high potential for reducing crime and delinquency. The January budget proposed $30 million in new budget authority for these programs in 1978; the revised budget restores the 1977 level of $75 million. This increase is offset by reductions in other activities of lower priority.

The revised request for 1978 includes $175 million in outlays for the Legal Services Corporation to assure that legal aid will be available to persons with low income who become involved in noncriminal cases. This is an increase of $85 million over the January budget, and represents significant growth above the 1977 level.

Additional funds are requested in both 1977 and 1978 for the Civil Rights Division of the Department of Justice; additional personnel are proposed for a task force seeking ways to remove sex discrimination and for improving Division capabilities in meeting other responsibilities. The January request for $12 million of additional budget authority and outlays in 1978 to provide for the expansion of the Bureau of Alcohol, Tobacco and Firearms program to curtail illegal commerce in firearms is withdrawn.

800: General Government

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Legislative functions	779	805	805	837	837
Executive direction and management	71	79	83	74	83
Central fiscal operations:					
Collection of taxes	1,692	1,813	1,814	1,881	1,874
Other fiscal operations	121	177	195	250	250
Subtotal	1,813	1,990	2,009	2,130	2,123
General property and records management	352	355	356	339	339
Central personnel management	99	109	109	113	113
Other general government:					
Territories	128	138	138	111	111
Proposed legislation	--------	--------	--------	9	9
Treasury claims	137	219	219	228	228
Other	266	192	192	214	229
Subtotal	532	549	549	563	578
Deductions for offsetting receipts	−272	−184	−184	−152	−152
Total budget authority	**3,372**	**3,705**	**3,728**	**3,904**	**3,922**
OUTLAYS:					
Legislative functions	677	868	868	914	914
Executive direction and management	68	80	84	74	83
Central fiscal operations:					
Collection of taxes	1,682	1,801	1,802	1,884	1,877
Other fiscal operations	116	182	200	240	240
Subtotal	1,798	1,983	2,002	2,124	2,117
General property and records management	95	328	329	358	359
Central personnel management	107	110	110	111	111
Other general government:					
Territories	117	151	151	112	112
Proposed legislation	--------	--------	--------	4	4
Treasury claims	142	219	219	228	228
Other	195	175	175	156	164
Subtotal	454	545	545	500	509
Deductions for offsetting receipts	−272	−184	−184	−152	−152
Total outlays	**2,927**	**3,731**	**3,754**	**3,930**	**3,941**

Outlays for general government programs are now estimated to be $3.8 billion in 1977 and $3.9 billion in 1978. These amounts are $23 million and $11 million above the January budget estimates for 1977 and 1978, respectively.

Additional resources are requested to permit the Treasury Department to process the economic stimulus payments and tax rebates. The revised budget does not provide for the expansion of IRS enforcement activities targeted at high level drug traffickers beyond the 1976 program level, as proposed in the January budget. Before increasing this activity, it is necessary to develop a comprehensive drug strategy, reexamine tax administration policies, and evaluate the effectiveness of tax enforcement in combating drug trafficking.

The budget revisions proposed for intergovernmental personnel assistance result in increases in budget authority of $15 million and outlays of $8 million in 1978 over the level recommended in the January budget. These increases reflect the administration's recommendation to continue funding new grants to State and local governments for personnel management improvement at the 1977 levels.

The administration is proposing increased funding for the Commission on Federal Paperwork to enable the Commission to complete its ongoing studies and make its final report in October 1977.

850: Revenue Sharing and General Purpose Fiscal Assistance

(In millions of dollars)

Subfunction and major program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
General revenue sharing:					
General revenue sharing payments	6,350	6,655	6,655	6,855	6,855
Administration	3	6	7	5	8
Subtotal	6,353	6,661	6,662	6,860	6,863
Other general purpose fiscal assistance:					
Antirecession fiscal assistance	--------	938	938	--------	--------
Proposed legislation	--------	--------	925	--------	1,550
Payments to States and counties from Federal forest and land activities	270	297	297	563	563
Payments to Puerto Rico and the Virgin Islands from duties, taxes, and fees	359	349	349	357	357
Payments to the District of Columbia	255	245	246	298	308
Taxable municipal bond option (proposed legislation)	--------	--------	--------	990	990
New York City seasonal financing fund	2,301	1	1	1	1
Mineral impact loan assistance (proposed legislation)	--------	--------	--------	--------	40
Special payments to territories (proposed legislation)	--------	--------	--------	--------	15
Other	4	5	5	5	5
Subtotal	3,189	1,835	2,761	2,214	3,829
Total budget authority	**9,542**	**8,496**	**9,423**	**9,074**	**10,692**
OUTLAYS:					
General revenue sharing:					
General revenue sharing payments	6,238	6,776	6,776	6,814	6,814
Administration	2	6	7	5	8
Subtotal	6,240	6,782	6,783	6,819	6,822
Other general purpose fiscal assistance:					
Antirecession fiscal assistance	--------	1,250	1,250	--------	--------
Proposed legislation	--------	--------	925	--------	1,550
Payments to States and counties from Federal forest and land activities	269	299	299	565	565
Payments to Puerto Rico and the Virgin Islands from duties, taxes, and fees	373	349	349	356	356
Payments to the District of Columbia	232	245	246	298	308
Taxable municipal bond option (proposed legislation)	--------	--------	--------	44	44
New York City seasonal financing fund	*	1	1	2	2
Mineral impact loan assistance (proposed legislation)	--------	--------	--------	--------	40
Special payments to territories (proposed legislation)	--------	--------	--------	--------	15
Other	4	*	*	5	5
Subtotal	879	2,144	3,070	1,270	2,885
Total outlays	**7,119**	**8,926**	**9,853**	**8,089**	**9,707**

*$500 thousand or less.

The major change in this function is the proposed extension and expansion of the antirecession fiscal assistance program, which provides funds to States and localities that are experiencing high rates of unemployment. While the program is now authorized until the end of 1977, current rates of unemployment will cause all available funds to be spent before that time. The January budget requested no additional funds for this program. The revised budget request includes the funds necessary to carry out the program for the rest of 1977. In addition, as part of the economic stimulus package, the budget requests that the program be enlarged and extended through 1982. Under this proposal, the amounts disbursed to areas of high unemployment will be increased. The new formula will provide for quarterly payments equal to $125 million plus $30 million for each one-tenth of a percentage point that the national unemployment rate two quarters earlier exceeds 6%. The proposed effective date for this new formula is April 1977. The outlay effect of these proposals is estimated at $0.9 billion in 1977 and $1.6 billion in 1978.

Other changes in this function include a $10 million increase in the 1978 Federal payment to the District of Columbia. The Interior Department requests $40 million in budget authority and outlays for loans for community facilities. Under this new proposal, States would receive loans for construction of community facilities necessitated by mineral development on public lands. The submission of this proposal is contingent upon enactment of legislation to correct deficiencies in Public Law 94–579 that result in high, open-ended costs for mineral loan programs. Legislation is also proposed to provide a one-time payment to the Governments of American Samoa, Guam, and the Virgin Islands in 1978 as reimbursement for the revenue losses incurred by refunding the $50 rebate to taxpayers residing in those territories. The estimated amounts for payments are subject to future certification. The amounts shown for the proposed taxable municipal bond option have not been changed. However, this administration is reexamining the legislative proposal and will make changes at a later date.

900: Interest

(In millions of dollars)

Subfunction	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Interest on the public debt	37,063	42,000	42,300	44,600	46,800
Other interest:					
Existing law	−2,472	−4,013	−4,013	−4,866	−4,866
Proposed legislation	--------	--------	−39	--------	−150
Subtotal	−2,472	−4,013	−4,052	−4,866	−5,016
Total budget authority	**34,591**	**37,987**	**38,248**	**39,734**	**41,784**
OUTLAYS:					
Interest on the public debt	37,063	42,000	42,300	44,600	46,800
Other interest:					
Existing law	−2,474	−4,013	−4,013	−4,865	−4,865
Proposed legislation	--------	--------	−39	--------	−150
Subtotal	−2,474	−4,013	−4,052	−4,865	−5,015
Total outlays	**34,589**	**37,987**	**38,248**	**39,735**	**41,785**

Interest outlays under the revised budget request are estimated to be $38.2 billion in 1977 and $41.8 billion in 1978. The revised estimates are higher than the January budget estimates by $0.3 billion in 1977 and $2.0 billion in 1978. These changes result from financing higher deficits at higher interest rates than assumed in the January budget.

The revised estimates are based on budget deficits of $68 billion in 1977 and $58 billion in 1978. These compare to deficits of $57 billion and $47 billion, respectively, in the January budget. Interest rates are assumed to remain constant at the rates in effect at the time the estimates were made. The short-term interest rate for 91-day Treasury bills at that time was 4.6%, 0.2 percentage points higher than assumed in the January budget.

Legislation is proposed to authorize the investment of Government balances held by private financial institutions in the form of demand deposits. Currently, the Federal Government does not receive earnings on these balances. Upon enactment of this legislation, Treasury will begin to pay banks the full cost of services now provided by the banks at no charge or at less than full cost.

920: Allowances

(In millions of dollars)

Program	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY:					
Civilian agency pay raises	--------	--------	--------	1,199	1,199
Contingencies for other requirements	--------	--------	--------	1,750	1,750
Total budget authority	--------	--------	--------	2,949	2,949
OUTLAYS:					
Civilian agency pay raises	--------	--------	--------	1,151	1,151
Contingencies for other requirements	--------	--------	--------	1,500	1,500
Total outlays	--------	--------	--------	2,651	2,651

Allowances for the Federal civilian agency pay raise and contingencies are the same as in the January budget.

950: Undistributed Offsetting Receipts

(In millions of dollars)

Subfunction	1976 actual	1977 estimate January budget	1977 estimate Revised budget	1978 estimate January budget	1978 estimate Revised budget
BUDGET AUTHORITY AND OUTLAYS					
Employer share, employee retirement	−4,242	−4,592	−4,591	−4,670	−4,653
Interest received by trust funds	−7,800	−8,201	−8,176	−8,659	−8,607
Rents and royalties on the Outer Continental Shelf	−2,662	−2,600	−2,300	−3,100	−3,400
Total undistributed offsetting receipts	−14,704	−15,393	−15,067	−16,429	−16,660

The revised budget estimates for receipts from rents and royalties on the Outer Continental Shelf reflect the rescheduling of certain Outer Continental Shelf sales. As a result, the level of these receipts is now estimated to be $300 million less in 1977 than in the January budget, with a corresponding increase in 1978.

Estimates for employer share, employee retirement, and interest received by trust funds have been revised slightly due to changes in the underlying economic assumptions and withdrawal of legislative proposals affecting social security taxes.

PART 5

SUMMARY TABLES

EXPLANATORY NOTE RELATING TO THE SUMMARY TABLES

Types of tables.—This part consists of revised tables similar to those found in the annual budget. (See Part 9 of *the Budget of the United States Government, 1978.*)

- Tables 1 through 7 are short summary tables of the revised budget, often only one page each.
- Tables 8 and 9 provide greater detail in support of financial data in the first four tables.
- Tables 10 through 15 are historical in nature, giving data, for earlier years, comparable to those data in the preceding tables, and also giving information on budget outlays in current and constant (fiscal year 1972) prices, and the gross national product.

Periods covered.—Due to the change in fiscal year required by the Congressional Budget Act, the following periods are covered by the various columns:

- July 1 through June 30 for the 1976 and prior columns.
- July 1 through September 30, 1976, for the TQ column.
- October 1 through September 30 for the 1977 and subsequent columns.

Concepts followed.—The concepts used in the revised current and historical tables are those discussed in Part 7 of *The Budget of the United States Government, 1978.*

Table 1. BUDGET SUMMARY (in millions of dollars)

Description	1976 actual	TQ actual	1977 estimate	1978 estimate
Budget authority (largely appropriations):				
Available through current action by Congress	266,933	55,276	316,139	338,725
Available without current action by Congress	201,724	46,677	206,825	229,397
Deductions for offsetting receipts [1]	−53,321	−10,543	−58,920	−60,868
Total budget authority	**415,336**	**91,409**	**464,044**	**507,254**
Receipts, outlays, and surplus or deficit:				
Budget receipts:				
Federal funds	201,099	54,085	233,614	269,787
Trust funds	133,695	32,071	152,404	167,816
Interfund transactions	−34,789	−4,383	−36,641	−35,980
Total budget receipts	300,005	81,773	349,377	401,624
Budget outlays:				
Federal funds	269,969	65,106	309,501	337,757
Trust funds	131,286	34,023	144,557	157,596
Interfund transactions	−34,789	−4,383	−36,641	−35,980
Total budget outlays	366,456	94,746	417,417	459,373
Budget surplus or deficit (−):				
Federal funds	−68,870	−11,021	−75,887	−67,969
Trust funds	2,410	−1,952	7,847	10,220
Total budget deficit (−)	**−66,461**	**−12,973**	**−68,040**	**−57,749**
Outstanding debt, end of period:				
Gross Federal debt	631,866	646,379	727,040	802,350
Held by:				
Government agencies	151,566	148,052	155,713	165,223
The public	480,300	498,327	571,327	637,127

[1] These consist of intragovernmental transactions and proprietary receipts from the public.

Note.—The transactions of the Export-Import Bank were excluded from the budget by law as of Aug. 17, 1971. This provision was repealed effective Oct. 1, 1976. Accordingly, all budget totals for past years have been adjusted retroactively to include the transactions of the Export-Import Bank. This adjustment increases budget outlays and the budget deficits by:

	In millions
1972	$145
1973	548
1974	1,228
1975	1,504
1976	856
TQ	273
1977	899
1978	964

Table 2. **BUDGET RECEIPTS, OUTLAYS, AND BUDGET AUTHORITY**

(In millions of dollars)

Description	1976 actual	TQ actual	1977 estimate	1978 estimate
Receipts by source:				
Individual income taxes	131,603	38,801	148,917	179,222
Corporation income taxes	41,409	8,460	57,182	61,645
Social insurance taxes and contributions	92,714	25,760	108,006	123,814
Excise taxes	16,963	4,473	17,939	18,581
Estate and gift taxes	5,216	1,455	5,909	5,835
Custom duties	4,074	1,212	4,720	5,286
Miscellaneous receipts	8,026	1,612	6,704	7,241
Total budget receipts	**300,005**	**81,773**	**349,377**	**401,624**
Outlays by function:				
National defense [1]	89,996	22,518	100,075	111,947
International affairs	5,067	1,997	6,926	7,847
General science, space, and technology	4,370	1,161	4,461	4,737
Natural resources, environment, and energy	11,282	3,324	17,139	20,504
Agriculture	2,502	584	2,899	2,333
Commerce and transportation	17,248	4,700	15,769	20,093
Community and regional development	5,300	1,530	7,989	9,976
Education, training, employment, and social services	18,167	5,013	22,199	26,473
Health	33,448	8,720	39,505	44,485
Income security	127,406	32,796	141,573	146,549
Veterans benefits and services	18,432	3,962	18,388	19,143
Law enforcement and justice	3,320	859	3,705	3,862
General government	2,927	878	3,754	3,941
Revenue sharing and general purpose fiscal assistance	7,119	2,024	9,853	9,707
Interest	34,589	7,246	38,248	41,785
Allowances [2]				2,651
Undistributed offsetting receipts	−14,704	−2,567	−15,067	−16,660
Total budget outlays	**336,466**	**94,746**	**417,417**	**459,373**
Budget deficit (−)	**−66,461**	**−12,973**	**−68,040**	**−57,749**
Budget authority by function:				
National defense [1]	103,811	22,149	108,520	120,136
International affairs	6,564	1,382	7,982	10,293
General science, space, and technology	4,262	1,095	4,496	4,930
Natural resources, environment, and energy	19,283	2,607	17,655	20,462
Agriculture	4,157	309	1,718	2,729
Commerce and transportation	20,890	7,496	15,034	19,514
Community and regional development	5,708	653	10,631	9,312
Education, training, employment, and social services	21,217	5,321	24,624	26,679
Health	33,649	8,505	40,307	47,847
Income security	140,019	28,562	174,085	179,843
Veterans benefits and services	19,678	4,529	19,073	19,062
Law enforcement and justice	3,297	829	3,586	3,760
General government	3,372	892	3,728	3,922
Revenue sharing and general purpose fiscal assistance	9,542	2,402	9,423	10,692
Interest	34,591	7,244	38,248	41,784
Allowances [2]				2,949
Undistributed offsetting receipts	−14,704	−2,567	−15,067	−16,660
Total budget authority	**415,336**	**91,409**	**464,044**	**507,254**

1 Includes allowances for civilian and military pay raises for Department of Defense.
2 Includes allowances for civilian agency pay raises and contingencies.

Table 3. BUDGET AUTHORITY BY AGENCY (in millions of dollars)

Department or other unit	1976 actual	TQ actual	1977 estimate	1978 estimate
Legislative branch	923	224	971	1,051
The Judiciary	345	87	422	441
Executive Office of the President	69	18	78	82
Funds appropriated to the President	10,566	−921	3,211	5,339
Agriculture	15,002	2,956	13,943	14,635
Commerce	2,252	466	6,033	4,196
Defense—Military (including pay raises)	95,712	23,089	108,260	118,929
Defense—Civil	2,196	659	2,495	2,608
Health, Education, and Welfare	128,244	34,248	146,706	162,181
Housing and Urban Development	28,498	403	35,867	39,151
Interior	2,541	1,012	3,406	3,593
Justice	2,175	534	2,329	2,348
Labor	20,379	3,654	26,183	26,650
State	931	372	1,308	1,385
Transportation	10,276	4,969	9,126	13,318
Treasury	46,772	10,135	53,981	55,660
Energy Research and Development Administration	4,515	1,264	6,389	7,753
Environmental Protection Agency	771	189	6,034	5,344
General Services Administration	161	−12	203	290
National Aeronautics and Space Administration	3,550	932	3,723	4,033
Veterans Administration	19,651	4,523	19,047	19,036
Other independent agencies	34,510	5,177	29,397	32,940
Allowances [1]	--------	--------	--------	2,949
Undistributed offsetting receipts:				
Employer share, employee retirement	−4,242	−985	−4,591	−4,653
Interest received by trust funds	−7,800	−270	−8,176	−8,607
Rents and royalties on the Outer Continental Shelf	−2,662	−1,311	−2,300	−3,400
Total budget authority	**415,336**	**91,409**	**464,044**	**507,254**
MEMORANDUM				
Portion available through current action by Congress [2]	266,933	55,276	316,139	338,725
Portion available without current action by Congress	201,724	46,677	206,825	229,397
Deductions for offsetting receipts:				
Intragovernmental transactions	−39,424	−5,272	−43,039	−43,398
Proprietary receipts from the public	−13,898	−5,271	−15,881	−17,470
Total budget authority	**415,336**	**91,409**	**464,044**	**507,254**

[1] Includes allowances for civilian agency pay raises and contingencies.
[2] Budget authority excludes appropriations to liquidate contract authority.

Table 4. OUTLAYS BY AGENCY (in millions of dollars)

Department or other unit	1976 actual	TQ actual	1977 estimate	1978 estimate
Legislative branch	775	224	1,016	1,102
The Judiciary	325	85	398	440
Executive Office of the President	79	16	85	82
Funds appropriated to the President	3,525	1,221	4,333	5,697
Agriculture	12,796	3,850	14,411	14,951
Commerce	2,020	534	3,241	4,974
Defense—Military (including pay raises)	88,036	21,926	98,050	109,166
Defense—Civil	2,124	583	2,469	2,591
Health, Education, and Welfare	128,785	34,341	148,230	161,702
Housing and Urban Development	7,079	1,397	7,704	8,852
Interior	2,293	788	3,548	3,361
Justice	2,242	551	2,428	2,438
Labor	25,727	5,905	24,004	25,197
State	1,062	316	1,213	1,266
Transportation	11,936	3,003	12,774	14,991
Treasury	44,335	9,699	54,400	54,655
Energy Research and Development Administration	3,759	1,051	5,375	6,419
Environmental Protection Agency	3,118	1,108	5,309	6,073
General Services Administration	−92	3	176	305
National Aeronautics and Space Administration	3,670	953	3,733	3,913
Veterans Administration	18,415	3,957	18,370	19,123
Other independent agencies	19,160	5,801	21,217	26,084
Allowances [1]	-------	-------	-------	2,651
Undistributed offsetting receipts:				
Employer share, employee retirement	−4,242	−985	−4,591	−4,653
Interest received by trust funds	−7,800	−270	−8,176	−8,607
Rents and royalties on the Outer Continental Shelf	−2,662	−1,311	−2,300	−3,400
Total budget outlays	**366,466**	**94,746**	**417,417**	**459,373**
MEMORANDUM				
Portion available through current action by Congress	158,321	30,077	196,489	206,891
Portion available without current action by Congress	117,871	16,542	136,495	154,572
Outlays from obligated balances [2]	71,952	34,952	84,284	106,254
Outlays from unobligated balances [2]	71,644	23,719	59,068	52,524
Deductions for offsetting receipts:				
Intragovernmental transactions	−39,424	−5,272	−43,039	−43,398
Proprietary receipts from the public	−13,898	−5,271	−15,881	−17,470
Total budget outlays	**366,466**	**94,746**	**417,417**	**459,373**

[1] Includes allowances for civilian agency pay raises and contingencies.
[2] Outlays from appropriations to liquidate contract authority are included as outlays from balances.

Table 5. BUDGET AUTHORITY AVAILABLE THROUGH CURRENT ACTION BY CONGRESS (in millions of dollars)

Department or other unit	1976 actual	TQ actual	1977 estimate	1978 estimate
Legislative branch	934	226	983	1,063
The Judiciary	343	86	451	438
Executive Office of the President	69	18	78	82
Funds appropriated to the President	5,524	781	6,711	8,447
Agriculture	14,049	2,623	13,108	13,572
Commerce	1,986	391	5,682	3,862
Defense—Military [1]	95,858	23,080	108,425	119,098
Defense—Civil	2,261	681	2,572	2,692
Health, Education, and Welfare	42,024	11,870	50,980	54,363
Housing and Urban Development	26,370	154	34,850	37,932
Interior	3,074	1,108	4,018	4,131
Justice	2,179	566	2,335	2,355
Labor	12,040	900	14,980	12,146
State	878	376	1,233	1,287
Transportation	6,768	1,478	5,093	5,791
Treasury Department	4,976	969	17,982	19,645
Energy Research and Development Administration	4,515	1,264	6,389	7,753
Environmental Protection Agency	772	189	6,034	5,344
General Services Administration	367	83	375	395
National Aeronautics and Space Administration	3,552	932	3,724	4,035
Veterans Administration	19,219	4,515	18,580	18,525
Other independent agencies	19,175	2,988	11,554	12,824
Allowances [2]	-------	-------	-------	2,949
Total budget authority available through current action by Congress	**266,933**	**55,276**	**316,139**	**338,725**
MEMORANDUM				
Appropriations to liquidate contract authority: [3]				
Funds appropriated to the President	437	38	185	205
Agriculture	303	85	313	269
Commerce	316	71	388	372
Housing and Urban Development	4,576	729	7,138	8,310
Interior	142	41	84	55
Transportation	8,630	1,805	8,863	8,581
Environmental Protection Agency	865	819	3,849	5,000
Veterans Administration	81	-------	-------	-------
Other independent agencies	2	4	6	3
Total appropriations to liquidate contract authority	**15,353**	**3,590**	**20,827**	**22,795**

[1] Includes allowances for civilian and military pay raises for Department of Defense.
[2] Includes allowances for civilian agency pay raises and contingencies.
[3] Excluded from budget authority above.

Table 6. **OUTLAYS FROM BUDGET AUTHORITY AVAILABLE THROUGH CURRENT ACTION BY CONGRESS** (in millions of dollars)

Department or other unit	1976 actual	TQ actual	1977 estimate	1978 estimate
Legislative branch	748	167	915	989
The Judiciary	298	60	386	401
Executive Office of the President	61	12	73	76
Funds appropriated to the President	890	203	2,991	3,618
Agriculture	10,206	2,530	13,082	11,864
Commerce	1,010	207	2,013	1,970
Defense—Military [1]	69,035	13,526	72,525	78,777
Defense—Civil	1,657	89	1,902	1,997
Health, Education, and Welfare	28,183	5,902	34,817	36,695
Housing and Urban Development	553	33	831	889
Interior	2,112	296	2,984	2,783
Justice	1,357	284	1,547	1,621
Labor	6,482	433	9,583	8,759
State	719	243	960	997
Transportation	3,193	490	3,565	3,980
Treasury Department	2,440	427	16,052	16,713
Energy Research and Development Administration	1,836	401	2,572	2,804
Environmental Protection Agency	340	47	753	491
General Services Administration	336	48	325	353
National Aeronautics and Space Administration	2,676	430	2,831	2,844
Veterans Administration	17,148	2,689	16,044	15,970
Other independent agencies	7,040	1,561	9,737	9,648
Allowances [2]	-------	-------	-------	2,651
Total outlays from budget authority available through current action by Congress	**158,321**	**30,077**	**196,489**	**206,891**
MEMORANDUM				
From appropriations to liquidate contract authority: [3]				
Funds appropriated to the President	275	-------	-------	-------
Agriculture	209	85	313	229
Commerce	316	71	388	372
Housing and Urban Development	2,416	649	3,331	4,362
Interior	122	17	84	55
Transportation	7,917	1,467	7,557	8,360
Environmental Protection Agency	810	798	3,618	4,380
Veterans Administration	63	-------	-------	-------
Other independent agencies	−5	-------	-------	-------
Total outlays from appropriations to liquidate contract authority	**12,122**	**3,087**	**15,290**	**17,758**

[1] Includes allowances for civilian and military pay raises for Department of Defense.
[2] Includes allowances for civilian agency pay raises and contingencies.
[3] Excluded from outlays above.

Table 7. BUDGET FINANCING AND OUTSTANDING DEBT

(In millions of dollars)

BUDGET FINANCING

Description	1976 actual	TQ actual	1977 estimate	1978 estimate
Budget surplus or deficit (—)	−66,461	−12,973	−68,040	−57,749
Deficit (—), off-budget Federal entities [1]	−7,196	−1,767	−10,785	−8,506
Total deficit (—)	−73,657	−14,740	−78,824	−66,255
Means of financing other than borrowing from the public:				
Decrease or increase (—) in cash and monetary assets	−7,964	−2,860	5,714	--------
Increase or decrease (—) in liabilities for:				
Checks outstanding, etc.[2]	−951	−546	−185	−34
Deposit fund balances	−1,099	20	−153	−42
Seigniorage on coins	747	99	448	531
Total, means of financing other than borrowing from the public	−9,265	−3,287	5,824	455
Total requirements for borrowing from the public	−82,922	−18,027	−73,000	−65,800
Reclassification of securities [3]	−471	--------	--------	--------
Change in debt held by the public	83,393	18,027	73,000	65,800
Nonbank investors	50,875	14,632		
Commercial banks	22,821	1,414		
Federal Reserve System	9,697	1,981		

OUTSTANDING DEBT, END OF YEAR

	1975 actual				
Gross Federal debt:					
Debt issued by Treasury	533,188	620,432	634,701	716,750	793,455
Debt issued by other agencies	10,943	11,433	11,678	10,290	8,895
Total gross Federal debt	544,131	631,866	646,379	727,040	802,350
Held by:					
Government agencies	147,225	151,566	148,052	155,713	165,223
The public	396,906	480,300	498,327	571,327	637,127
Federal Reserve System	**84,993**	**94,714**	**96,702**		
Others	**311,913**	**385,586**	**401,625**		

DEBT SUBJECT TO STATUTORY LIMITATION, END OF YEAR

Debt issued by Treasury	533,188	620,432	634,701	716,750	793,455
Treasury debt not subject to limitation	−624	−613	−613	−613	−613
Agency debt subject to limitation	1,622	1,716	1,713	1,745	1,793
Notes not part of Federal debt but included in debt limit [4]	20	20	20	20	20
Total debt subject to statutory limitation [5]	**534,207**	**621,555**	**635,822**	**717,902**	**794,655**

[1] Includes Exchange stabilization fund.
[2] Includes military payment certificates, accrued interest (less unamortized discount) on Treasury debt, and as offset certain collections in transit.
[3] As of July 1, 1975, Federal debt held by the public increased by $471 million due to a retroactive reclassification of Export-Import Bank certificates of beneficial interest from asset sales to debt.
[4] District of Columbia stadium bonds.
[5] The statutory debt limit is permanently established at $400 billion. Public Law 94–334 temporarily increased the statutory debt limit to $682 billion through Mar. 31, 1977 and to $700 billion through Sept. 30, 1977. Legislation is required to change the limitation.

Table 8. **BUDGET RECEIPTS BY SOURCE** (in millions of dollars)

Source	1976 actual	TQ actual	1977 estimate	1978 estimate
Individual income taxes:				
Withheld	123,441	32,950	152,915	186,161
Other	35,528	6,809	41,281	47,508
Proposed legislation	-------	-------	−1,690	−11,553
Gross individual income taxes	158,969	39,759	192,506	222,116
Refunds	−27,367	−958	−35,368	−41,559
Proposed legislation	-------	-------	−8,221	−1,335
Net individual income taxes	**131,603**	**38,801**	**148,917**	**179,222**
Corporation income taxes	**46,783**	**9,809**	**63,573**	**70,496**
Proposed legislation	-------	-------	−714	−2,851
Refunds	−5,374	−1,348	−5,677	−6,000
Net corporation income taxes	**41,409**	**8,460**	**57,182**	**61,645**
Social insurance taxes and contributions (trust funds):				
Employment taxes and contributions:				
Old-age and survivors insurance	58,703	15,886	67,528	74,556
Proposed legislation	-------	-------	-------	36
Disability insurance	7,686	2,130	8,875	10,150
Proposed legislation	-------	-------	-------	7
Hospital insurance	11,995	3,459	13,717	17,849
Proposed legislation	-------	-------	-------	9
Railroad retirement	1,525	328	1,860	1,855
Total employment taxes and contributions	79,909	21,803	91,980	104,462
Unemployment insurance:				
State taxes deposited in Treasury [1]	6,404	2,289	8,800	11,229
Federal unemployment tax receipts [1]	1,531	371	1,900	2,700
Railroad unemployment tax receipts [1]	118	37	183	217
Total unemployment insurance	8,054	2,698	10,883	14,146
Contributions for other insurance and retirement:				
Supplementary medical insurance	1,937	539	2,180	2,374
Proposed legislation	-------	-------	−37	−182
Federal employees' retirement—employee contributions	2,760	707	2,944	2,958
Other retirement contributions [2]	54	13	56	56
Total contributions for other insurance and retirement	4,752	1,259	5,143	5,206
Total social insurance taxes and contributions	**92,714**	**25,760**	**108,006**	**123,814**
Excise taxes:				
Federal funds:				
Alcohol taxes:				
Distilled spirits	3,882	848	4,051	4,199
Beer	1,330	391	1,431	1,502
Rectification tax	29	22	32	34
Wines	172	35	172	171
Special taxes in connection with liquor occupations	15	10	20	21
Refunds	−110	−27	−115	−117
Total alcohol taxes	5,318	1,279	5,591	5,810

See footnotes at end of table.

Table 8. **BUDGET RECEIPTS BY SOURCE** (in millions of dollars)—**Continued**

Source	1976 actual	TQ actual	1977 estimate	1978 estimate
Excise taxes—Continued				
Federal funds—Continued				
Tobacco taxes:				
Cigarettes	2,435	610	2,527	2,648
Cigars	50	12	49	48
Cigarette papers and tubes	1	*	2	2
Other	2	1	2	2
Refunds	−4	−1	−5	−5
Total tobacco taxes	2,484	622	2,575	2,695
Manufacturers' excise taxes:				
Gasoline	31	8	33	34
Firearms, shells, and cartridges	54	15	66	74
Fishing rods, creels, etc	20	7	25	28
Pistols and revolvers	12	4	14	16
Bows and arrows	5	1	6	6
Other	1	-------	-------	-------
Refunds	−7	−7	−10	−10
Total manufacturers' excise taxes	115	29	134	148
Miscellaneous excise taxes:				
General and toll telephone and teletype service	1,837	543	1,805	1,672
Wagering taxes, including occupational taxes	6	2	7	7
Sugar tax	29	*	-------	-------
Coin-operated gaming devices	6	5	8	8
Interest equalization tax	1	1	-------	-------
Tax on foundations	62	2	56	55
Foreign insurance policies	25	8	29	34
Other	1	*	1	1
Refunds	−20	−10	−16	−17
Total miscellaneous excise taxes	1,948	551	1,890	1,760
Undistributed Federal tax deposits and unapplied collections	747	40	−97	40
Total Federal fund excise taxes	10,612	2,520	10,093	10,453
Trust funds:				
Highway:				
Gasoline	3,997	1,110	4,395	4,549
Trucks, buses, and trailers	219	50	587	547
Tires, innertubes, and tread rubber	594	225	831	866
Diesel fuel used on highways	347	116	457	489
Use-tax on certain vehicles	209	110	254	265
Truck parts and accessories	116	39	151	166
Lubricating oils	83	26	119	123
Refunds	−152	−1	−139	−148
Total highway trust fund	5,413	1,676	6,655	6,857

See footnotes at end of table.

Table 8. **BUDGET RECEIPTS BY SOURCE** (in millions of dollars)—**Continued**

Source	1976 actual	TQ actual	1977 estimate	1978 estimate
Excise taxes—Continued				
Trust funds—Continued				
Airport and airway:				
Transportation of persons	777	225	974	1,040
Waybill tax	42	14	64	66
Tax on fuels	52	14	74	79
International departure tax	47	16	54	59
Aircraft registration fees	21	8	26	28
Tires and innertubes	1	*	1	1
Refunds	−2	−1	−2	−2
Total airport and airway trust fund	938	277	1,191	1,271
Total trust fund excise taxes	6,351	1,953	7,846	8,128
Total excise taxes	**16,963**	**4,473**	**17,939**	**18,581**
Estate and gift taxes	**5,216**	**1,455**	**5,909**	**5,835**
Customs duties	**4,074**	**1,212**	**4,720**	**5,286**
Miscellaneous receipts: [3]				
Miscellaneous taxes	209	61	222	227
Proposed legislation	--------	--------	--------	80
Deposit of earnings, Federal Reserve System	5,451	1,500	6,000	6,400
Fees for permits and regulatory and judicial services:				
Immigration, passport, and consular fees	51	13	54	56
Patent and copyright fees	28	10	31	33
Registration and filing fees	144	22	83	73
Import fees on crude oil and petroleum products	1,890	−50	65	100
Miscellaneous fees for permits, licenses, etc	28	7	36	38
Miscellaneous fees for regulatory and judicial services	45	9	55	46
Proposed legislation	--------	--------	--------	19
Fees for legal and judicial services	*	*	*	*
Total fees for permits and regulatory and judicial services	2,186	11	323	365
Fine, penalties, and forfeitures	94	32	99	101
War reparations and recoveries under military occupation	65	1	4	4
Gifts and contributions	22	5	58	64
Refunds	−2	−*	--------	--------
Total miscellaneous receipts	**8,026**	**1,612**	**6,704**	**7,241**
Total budget receipts	**300,005**	**81,773**	**349,377**	**401,624**
MEMORANDUM				
Federal funds	201,099	54,085	233,614	269,787
Trust funds	133,695	32,071	152,404	167,816
Interfund transactions	−34,789	−4,383	−36,641	−35,980

*$500 thousand or less.

[1] Deposits by States are State payroll taxes that cover the benefit part of the program. Federal unemployment tax receipts cover administrative costs at both the Federal and State level. Railroad unemployment tax receipts cover both the benefits and administrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the Civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds. Trust fund amounts in miscellaneous receipts are: 1976, $33 million; TQ, $8 million; 1977, $72 million; and 1978, $79 million.

Note.—Estimates for 1977 and 1978 include effects of proposed legislation.

Table 9. OFFSETTING RECEIPTS BY TYPE (in millions of dollars)

Type	1976 actual	TQ actual	1977 estimate	1978 estimate
INTRAGOVERNMENTAL TRANSACTIONS				
Intrabudgetary transactions:				
Federal intrafund transactions:				
Interest on Government capital in enterprises	1,431	411	1,787	1,912
Other	43	27	41	42
Total Federal intrafunds	1,473	438	1,828	1,955
Trust intrafund transactions: [1]				
Railroad retirement/social security	1,239	--------	1,319	1,577
Other	5	2	11	1
Total trust intrafunds	1,244	2	1,330	1,578
Total intrafund transactions	2,717	440	3,159	3,533
Interfund transactions:				
Distributed by agency and function:				
Federal fund payments to trust funds:				
Contributions to insurance programs:				
Old-age and survivors insurance	268	--------	236	228
Military service credits, various programs	295	--------	622	656
Supplementary medical insurance	2,939	878	5,053	6,603
Hospital insurance	610	--------	803	656
Railroad dual benefits	250	--------	250	250
Supplementary retirement contributions	4,805	2	7,423	7,036
Unemployment insurance	7,878	625	3,600	1,100
Other	2	1	48	51
Miscellaneous contributions:				
State and local government fiscal assistance	6,355	1,664	6,655	6,855
Other	161	20	205	213
Subtotal	23,564	3,190	24,893	23,648
Trust fund payments to Federal funds:				
Charges for services to trust funds	187	33	165	185
Other	5	--------	--------	--------
Subtotal	192	33	165	185
Total interfunds distributed by agency and function	23,756	3,223	25,058	23,833
Undistributed by agency and function:				
Employer share, employee retirement:				
Civil service retirement and disability insurance	2,080	592	2,219	2,228
Old-age, survivors, disability, and hospital insurance (contribution as employer) [2]	1,138	294	1,169	1,293
Other Federal employees retirement	15	4	18	19
Total employer share, employee retirement	3,233	890	3,406	3,540
Interest received by trust funds	7,800	270	8,176	8,607
Total interfunds undistributed by agency and function	11,033	1,160	11,582	12,147
Total interfund transactions	34,789	4,383	36,641	35,980
Total intrabudgetary transactions	37,506	4,823	39,800	39,513

See footnotes at end of table.

Table 9. OFFSETTING RECEIPTS BY TYPE (in millions of dollars)—Continued

Type	1976 actual	TQ actual	1977 estimate	1978 estimate
INTRAGOVERNMENTAL TRANSACTIONS—Con.				
Receipts from off-budget Federal entities:				
Distributed by agency and function:				
Interest on loans to Government-owned enterprises	909	354	2,054	2,772
Undistributed by agency and function:				
Employer share, employee retirement	1,009	95	1,185	1,113
Total receipts from off-budget Federal entities	1,918	449	3,239	3,885
Total intragovernmental transactions	39,424	5,272	43,039	43,398
PROPRIETARY RECEIPTS FROM THE PUBLIC				
Distributed by agency and function:				
Interest:				
Interest on loans, Foreign Assistance Act	187	87	245	265
Interest on foreign military credit sales	78	29	100	95
Interest on loans to United Kingdom	59	--------	58	56
Other interest on foreign loans and deferred foreign collections	26	3	13	13
Interest on rural electrification loans	2	2	3	3
Other interest (domestic—civil) [3] [4]	163	102	180	302
Other interest (domestic—national defense)	10	1	10	10
Total interest	525	225	610	744
Dividends and other earnings	*	12	2	2
Rents:				
Rent and bonuses from land leases for resource exploration and extraction	13	9	15	16
Rent of land and other real property [3]	71	7	79	67
Rent of equipment and other personal property	21	*	21	21
Total rents	105	16	114	104
Royalties [3]	380	69	375	513
Sale of products:				
Sale of timber and other natural land products [3]	633	289	755	859
Sale of power and other utilities	292	88	717	889
Sale of other products	59	15	36	29
Recovery of mint manufacturing expense	41	10	43	46
Total sale of products	1,025	403	1,552	1,823
Fees and other charges for services and special benefits:				
Veterans life insurance (trust funds)	458	148	498	521
Other [3]	390	127	439	502
Total fees and other charges	848	275	936	1,024
Sale of Government property:				
Sale of land and other real property [3]	31	16	47	45
Sale of equipment and other personal property:				
Sale from the stockpile of strategic and critical materials	160	63	124	61
Military assistance program sales (trust fund)	7,257	2,539	8,800	8,800
Other	20	3	33	7
Profit on the sale of gold	62	1	--------	--------
Sale of scrap and salvage material [3]	13	*	1	1
Total sale of property	7,542	2,623	9,005	8,913

See footnotes at end of table.

Table 9. OFFSETTING RECEIPTS BY TYPE (in millions of dollars)—Continued

Type	1976 actual	TQ actual	1977 estimate	1978 estimate
PROPRIETARY RECEIPTS FROM THE PUBLIC—Continued				
Distributed by agency and function—Continued				
Realization upon loans and investments:				
Dollar repayments of loans, Agency for International Development	201	100	283	300
Foreign military credit sales	128	71	206	208
Dollar conversion of foreign currency	95	15	85	85
Repayment of loans to United Kingdom	71	--------	73	74
Other	193	61	227	166
Total realization upon loans and investments	688	247	874	834
Recoveries and refunds [3]	113	96	112	112
Deposits in clearing accounts	9	−7	*	*
Total proprietary receipts from the public distributed by agency and function	11,235	3,960	13,581	14,070
Undistributed by agency and function:				
Rents and royalties on the Outer Continental Shelf:				
Rents and bonuses	1,662	1,132	1,600	2,600
Royalties	1,001	179	700	800
Total proprietary receipts from the public undistributed by agency and function	2,662	1,311	2,300	3,400
Total proprietary receipts from the public [5]	**13,898**	**5,271**	**15,881**	**17,470**
Total offsetting receipts	**53,321**	**10,543**	**58,920**	**60,868**

*$500 thousand or less.

[1] Interchange receipts between the social security and railroad retirement funds place the social security funds in the same position they would have been if there were no separate railroad retirement system. Interchange receipts between Federal retirement funds occur when an employee transfers from coverage by one system to coverage by another system.

[2] Includes provision for covered Federal civilian employees and military personnel.

[3] Includes both Federal funds and trust funds.

[4] Includes $62 million in 1976 and $3 million in the transition quarter arising from interest on public debt securities by funds held in escrow.

[5] Consists of:

	1976 actual	*TQ actual*	*1977 est.*	*1978 est.*
Federal funds	5,767	2,414	6,166	7,625
Trust funds	8,131	2,857	9,715	9,845

Table 10. **CONTROLLABILITY OF BUDGET OUTLAYS, 1968–78 (dollars in billions)**

	Actual										Estimate	
	1968	1969	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978
Relatively uncontrollable under present law:												
Open-ended programs and fixed costs:												
Payments for individuals:												
Social security and railroad retirement	24.8	28.3	31.3	37.2	41.5	50.7	57.6	68.4	76.2	20.7	87.1	95.7
Federal employees' retirement and insurance	4.3	4.8	5.6	6.6	7.7	9.0	10.8	13.3	15.6	4.3	18.0	20.3
(Military retired pay)	(2.1)	(2.4)	(2.8)	(3.4)	(3.9)	(4.4)	(5.1)	(6.2)	(7.3)	(1.9)	(8.2)	(9.0)
(Other)	(2.2)	(2.4)	(2.7)	(3.2)	(3.8)	(4.6)	(5.7)	(7.1)	(8.3)	(2.3)	(9.8)	(11.2)
Unemployment assistance [1]	2.9	2.9	3.7	6.6	7.5	5.7	6.5	14.0	19.8	4.2	16.4	13.8
Veterans benefits: Pensions, compensation, education and insurance	5.0	5.7	6.6	7.6	8.3	9.3	10.0	12.4	13.9	2.9	13.2	13.1
Medicare and medicaid	7.2	8.9	9.9	11.2	13.4	14.1	17.2	21.6	26.3	7.0	32.2	37.9
Housing payments	.3	.3	.5	.7	1.1	1.6	1.8	2.1	2.5	.6	2.9	3.8
Public assistance and related programs	3.4	3.9	4.7	7.4	8.9	9.1	11.5	16.9	20.2	4.9	21.9	22.9
Subtotal, payments for individuals	47.7	54.9	62.2	77.3	88.4	99.6	115.4	148.7	174.4	44.6	191.9	207.4
Net interest [2]	11.1	12.7	14.4	14.8	15.5	17.4	21.5	23.3	26.8	7.0	30.1	33.2
General revenue sharing	------	------	------	------	------	6.6	6.1	6.1	6.2	1.6	6.8	6.8
Farm price supports (CCC)	3.2	4.1	3.8	2.8	4.0	3.6	1.0	.6	.6	.7	1.7	1.0
Other open-ended programs and fixed costs	3.0	2.8	3.8	5.2	6.4	6.3	6.8	8.0	8.8	2.6	10.2	10.7
Total, open-ended programs and fixed costs	64.9	74.5	84.2	100.1	114.3	133.4	150.8	186.8	216.9	56.5	240.7	259.1
(National defense)	(2.2)	(2.6)	(3.0)	(3.4)	(4.0)	(4.1)	(4.7)	(5.4)	(6.8)	(1.2)	(7.8)	(9.1)
(Civilian programs)	(62.8)	(71.9)	(81.2)	(96.7)	(110.3)	(129.3)	(146.1)	(181.4)	(210.1)	(55.2)	(232.8)	(249.9)
Outlays from prior-year contracts and obligations: [3]												
National defense	24.6	25.0	24.5	21.6	19.9	18.3	20.9	23.6	19.1	8.6	23.6	31.4
Civilian programs	17.8	16.9	17.0	18.6	19.4	21.3	22.9	27.1	31.8	11.4	37.5	44.9
Total, outlays from prior-year contracts and obligations	42.3	41.9	41.5	40.2	39.2	39.6	43.8	50.7	50.9	20.0	61.1	76.3
Total, relatively uncontrollable outlays	**107.3**	**116.4**	**125.7**	**140.4**	**153.5**	**173.0**	**194.5**	**237.5**	**267.7**	**76.5**	**301.7**	**335.4**

Relatively controllable outlays:												
National defense	52.7	52.6	51.8	51.8	53.5	52.6	53.0	57.6	64.1	12.6	68.6	71.4
Civilian programs	20.7	17.6	21.4	21.9	27.7	23.8	24.2	33.5	38.8	6.6	51.7	57.2
Under current law [4]	(73.4)	(70.1)	(73.3)	(73.7)	(81.1)	(76.4)	(77.2)	(91.1)	(103.0)	(19.2)	(116.3)	(127.9)
Under proposed legislation in:												
Open-ended programs and fixed costs [4]	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	(*)	(−.9)
Relatively controllable and new programs [4]	-------	-------	-------	-------	-------	-------	-------	-------	-------	-------	(4.0)	(1.8)
Total, relatively controllable outlays	**73.4**	**70.1**	**73.3**	**73.7**	**81.1**	**76.4**	**77.2**	**91.1**	**103.0**	**19.2**	**120.3**	**128.6**
Undistributed employer share, employee retirement	**−1.8**	**−2.0**	**−2.4**	**−2.6**	**−2.8**	**−2.9**	**−3.3**	**−4.0**	**−4.2**	**−1.0**	**−4.6**	**−4.7**
Total budget outlays	**178.8**	**184.5**	**196.6**	**211.4**	**231.9**	**246.5**	**268.4**	**324.6**	**366.5**	**94.7**	**417.4**	**459.4**
MEMORANDUM												
Percent of total outlays:												
Relatively uncontrollable under present law:												
Open-ended programs and fixed costs:												
Payments for individuals	26.7%	29.7%	31.7%	36.6%	38.1%	40.4%	43.0%	45.8%	47.6%	47.1%	46.0%	45.1%
Other	9.6	10.6	11.3	10.8	11.1	13.7	13.2	11.7	11.6	12.5	11.7	11.3
Total open-ended programs and fixed costs	36.3	40.4	42.9	47.4	49.3	54.1	56.2	57.6	59.2	59.6	57.7	56.4
Outlays from prior-year contracts and obligations	23.7	22.7	21.1	19.0	16.9	16.1	16.3	15.6	13.9	21.1	14.6	16.6
Total relatively uncontrollable outlays	**60.0**	**63.1**	**64.0**	**66.4**	**66.2**	**70.2**	**72.5**	**73.2**	**73.1**	**80.7**	**72.3**	**73.0**
Relatively controllable outlays	**41.0**	**38.0**	**37.2**	**34.8**	**35.0**	**31.0**	**28.8**	**28.1**	**28.1**	**20.3**	**28.8**	**28.0**
Undistributed employer share, employee retirement	**−1.0**	**−1.1**	**−1.2**	**−1.2**	**−1.2**	**−1.2**	**−1.2**	**−1.2**	**−1.2**	**−1.0**	**−1.1**	**−1.0**
Total budget outlays	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

*Less than $500 thousand.
1 Includes $0.5 billion in 1977 and $0.4 billion in 1978 for extension of Federal supplemental benefits.
2 Proposed legislation in open-ended programs and fixed costs includes less than −$50 million in 1978 for net interest.
3 Excluding prior year contracts and obligations for activities shown as "open-ended programs and fixed costs."
4 National defense portion includes $68.6 billion in 1977 and $71.5 billion in 1978 under current law; −$0.1 billion in 1978 under proposed legislation in relatively controllable programs and less than $50 million in 1978 under proposed legislation in open-ended programs.

Table 11. **BUDGET RECEIPTS BY SOURCE, 1969-78 (in millions of dollars)**

Source	Actual									Estimate	
	1969	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978
Individual income taxes	87,249	90,412	86,230	94,737	103,246	118,952	122,386	131,603	38,801	148,917	179,222
Corporation income taxes	36,678	32,829	26,785	32,166	36,153	38,620	40,621	41,409	8,460	57,182	61,645
Social insurance taxes and contributions (trust funds):											
Employment taxes and contributions:											
Old-age and survivors insurance	25,484	29,396	31,354	35,132	40,703	47,778	55,207	58,703	15,886	67,528	74,592
Disability insurance	3,469	4,063	4,490	4,775	5,381	6,147	7,250	7,686	2,130	8,875	10,157
Hospital insurance	4,398	4,755	4,874	5,205	7,603	10,556	11,258	11,995	3,459	13,717	17,858
Railroad retirement	885	919	980	1,008	1,189	1,411	1,489	1,525	328	1,860	1,855
Total employment taxes and contributions	34,236	39,133	41,699	46,120	54,876	65,892	75,204	79,909	21,803	91,980	104,462
Unemployment insurance	3,328	3,464	3,674	4,357	6,051	6,837	6,771	8,054	2,698	10,883	14,146
Contributions for other insurance and retirement:											
Supplementary medical insurance	903	936	1,253	1,340	1,427	1,704	1,901	1,937	539	2,143	2,192
Employees' retirement—employee contributions	1,426	1,735	1,916	2,058	2,146	2,302	2,513	2,760	707	2,944	2,958
Other retirement contributions	24	29	37	39	41	45	52	54	13	56	56
Total contributions for other insurance and retirement	2,353	2,701	3,205	3,437	3,614	4,051	4,466	4,752	1,259	5,143	5,206
Total social insurance taxes and contributions	39,918	45,298	48,578	53,914	64,542	76,780	86,441	92,714	25,760	108,006	123,814

Excise taxes:											
Federal funds:											
Alcohol	4,482	4,610	4,696	5,004	5,040	5,248	5,238	5,318	1,279	5,591	5,810
Tobacco	2,136	2,093	2,205	2,205	2,274	2,435	2,312	2,484	622	2,575	2,695
Other	3,967	3,649	3,609	2,297	2,522	2,060	1,850	2,810	620	1,927	1,948
Total Federal excise taxes	10,585	10,352	10,510	9,506	9,836	9,743	9,400	10,612	2,520	10,093	10,453
Trust funds:											
Highway	4,637	5,354	5,542	5,322	5,665	6,260	6,188	5,413	1,676	6,655	6,857
Airport and airway	------	------	563	649	758	840	962	938	277	1,191	1,271
Total trust excise taxes	4,637	5,354	6,104	5,971	6,424	7,100	7,151	6,351	1,953	7,846	8,128
Total excise taxes	15,222	15,705	16,614	15,477	16,260	16,844	16,551	16,963	4,473	17,939	18,581
Estate and gift taxes	3,491	3,644	3,735	5,436	4,917	5,035	4,611	5,216	1,455	5,909	5,835
Customs duties	2,319	2,430	2,591	3,287	3,188	3,334	3,676	4,074	1,212	4,720	5,286
Miscellaneous receipts:											
Deposit of earnings by Federal Reserve System	2,662	3,266	3,533	3,252	3,495	4,845	5,777	5,451	1,500	6,000	6,400
Other miscellaneous receipts	247	158	325	381	426	524	934	2,575	112	704	841
Total miscellaneous receipts [1]	2,908	3,424	3,858	3,633	3,921	5,369	6,711	8,026	1,612	6,704	7,241
Total budget receipts	**187,784**	**193,743**	**188,392**	**208,649**	**232,225**	**264,932**	**280,997**	**300,005**	**81,773**	**349,377**	**401,624**
MEMORANDUM											
Federal funds	143,321	143,158	133,785	148,846	161,357	181,219	187,505	201,099	54,085	233,614	269,787
Trust funds	52,009	59,362	66,193	72,959	92,193	104,846	118,590	133,695	32,071	152,404	167,816
Interfund transactions	−7,547	−8,778	−11,586	−13,156	−21,325	−21,133	−25,098	−34,789	−4,383	−36,641	−35,980

1 Includes both Federal and trust funds.

Table 12. **BUDGET OUTLAYS BY FUNCTION, 1969-78 (in millions of dollars)**

Function	Actual									Estimate	
	1969	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978
050 National defense:											
051 Department of Defense—Military:											
Military personnel	21,374	23,031	22,633	23,036	23,246	23,728	24,968	25,064	6,358	26,212	25,959
Retired military personnel	2,444	2,849	3,386	3,885	4,390	5,128	6,242	7,296	1,947	8,234	9,035
Operation and maintenance	22,227	21,609	20,941	21,675	21,069	22,478	26,330	27,902	7,261	31,146	33,686
Procurement	23,988	21,584	18,858	17,131	15,654	15,241	16,042	15,964	3,766	18,710	23,510
Research, development, test and evaluation	7,457	7,166	7,303	7,881	8,157	8,582	8,866	8,923	2,206	9,993	11,181
Military construction and other [1]	525	1,059	1,552	1,655	895	2,627	2,754	3,043	383	3,931	5,971
Deductions for offsetting receipts	−143	−148	−126	−113	−113	−159	−182	−155	5	−176	−176
Subtotal, 051	77,872	77,150	74,546	75,151	73,297	77,625	85,020	88,036	21,926	98,050	109,166
052 Military assistance	789	731	999	806	531	819	999	501	183	250	576
053 Atomic energy defense activities	1,389	1,415	1,385	1,373	1,409	1,486	1,506	1,565	435	1,829	2,162
054 Defense-related activities	162	−8	−120	29	−162	−1,349	−936	−103	−27	−52	45
Deductions for offsetting receipts	−5	−3	−3	−2	−4	−13	−4	−3	1	−3	−3
Total national defense	**80,207**	**79,284**	**76,807**	**77,356**	**75,072**	**78,569**	**86,585**	**89,996**	**22,518**	**100,075**	**111,947**
150 International affairs:											
151 Foreign economic and financial assistance	3,142	2,935	2,902	3,235	2,870	2,884	3,665	3,568	1,526	5,129	5,611
152 Conduct of foreign affairs	370	398	405	451	475	606	658	726	262	1,038	1,096
153 Foreign information and exchange activities	237	235	241	274	295	320	348	382	115	394	422
155 International financial programs	246	219	−184	184	498	1,178	1,454	836	253	879	1,244
Deductions for offsetting receipts	−211	−223	−271	−277	−634	−167	−263	−446	−160	−512	−527
Total international affairs	**3,784**	**3,564**	**3,093**	**3,868**	**3,504**	**4,821**	**5,862**	**5,067**	**1,997**	**6,926**	**7,847**
250 General science, space, and technology:											
251 General science and basic research	938	947	1,009	978	961	1,018	1,038	1,035	292	1,077	1,216
253 Space flight	2,900	2,340	1,988	1,906	1,726	1,694	1,661	2,000	525	2,071	2,156
254 Space science, applications, and technology	794	853	830	952	1,041	947	958	980	251	960	986
255 Supporting space activities	387	370	355	338	304	322	334	358	94	354	381
Deductions for offsetting receipts	−4	−3	−2	−2	−1	−3	−2	−3	−1	−2	−2
Total general science, space, and technology	**5,016**	**4,508**	**4,180**	**4,174**	**4,030**	**3,977**	**3,989**	**4,370**	**1,161**	**4,461**	**4,737**

300 Natural resources, environment, and energy:											
301 Water resources and power	1,728	1,674	2,053	2,315	2,493	2,540	3,274	3,600	981	4,796	4,63
302 Conservation and land management	567	717	855	784	725	740	1,300	1,245	477	1,468	1,41
303 Recreational resources	380	372	476	521	566	665	825	895	256	1,284	1,44
304 Pollution control and abatement	303	384	702	764	1,122	2,035	2,522	3,067	1,091	5,210	5,98
305 Energy	952	931	831	1,028	1,015	623	1,611	2,385	649	4,133	6,92
306 Other natural resources	370	432	498	571	570	673	762	897	229	1,048	1,09
Deductions for offsetting receipts	−400	−467	−475	−463	−544	−705	−756	−807	−359	−800	−99
Total natural resources, environment, and energy	**3,901**	**4,043**	**4,941**	**5,521**	**5,947**	**6,571**	**9,537**	**11,282**	**3,324**	**17,139**	**20,504**
350 Agriculture:											
351 Farm income stabilization	5,304	4,589	3,651	4,553	4,099	1,458	785	1,574	343	1,773	1,188
352 Agricultural research and services	520	579	639	728	758	775	877	921	240	1,128	1,147
Deductions for offsetting receipts	−46	−5	−2	−2	−3	−3	−2	7	1	−2	−3
Total agriculture	**5,779**	**5,164**	**4,288**	**5,279**	**4,855**	**2,230**	**1,660**	**2,502**	**584**	**2,899**	**2,333**
400 Commerce and transportation:											
401 Mortgage credit and thrift insurance	−624	104	−251	−42	−1,192	1,519	2,810	1,229	276	−2,469	241
402 Postal Service	920	1,510	2,183	1,772	1,567	1,698	1,877	1,720	938	2,272	1,696
403 Other advancement and regulation of commerce	247	477	474	488	552	714	939	867	182	1,078	1,276
404 Ground transportation	4,443	4,678	5,180	5,353	5,640	5,583	6,501	9,305	2,284	10,119	11,683
405 Air transportation	1,220	1,422	1,824	1,925	2,177	2,236	2,408	2,557	587	2,843	3,205
406 Water transportation	874	913	1,052	1,111	1,231	1,354	1,459	1,558	417	1,885	1,976
407 Other transportation	21	26	37	36	56	57	74	65	28	83	85
Deductions for offsetting receipts	−36	−40	−103	−43	−101	−64	−60	−52	−12	−43	−67
Total commerce and transportation	**7,065**	**9,090**	**10,396**	**10,601**	**9,930**	**13,096**	**16,010**	**17,248**	**4,700**	**15,769**	**20,093**
450 Community and regional development:											
451 Community development	1,631	2,328	2,613	3,110	3,088	3,045	3,149	3,527	1,139	4,887	5,19
452 Area and regional development	566	593	680	836	879	1,111	912	1,266	299	2,440	4,36
453 Disaster relief and insurance	40	257	353	396	1,580	782	398	522	111	696	45
Deductions for offsetting receipts	−12	−13	−14	−16	−19	−27	−27	−15	−19	−33	−3
Total community and regional development	**2,224**	**3,166**	**3,632**	**4,325**	**5,529**	**4,911**	**4,431**	**5,300**	**1,530**	**7,989**	**9,97**

See footnotes at end of table.

Table 12. **BUDGET OUTLAYS BY FUNCTION, 1969-78 (in millions of dollars)—Continued**

Function	Actual									Estimate	
	1969	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978
500 Education, training, employment, and social services:											
501 Elementary, secondary, and vocational education	2,728	3,107	3,544	3,962	3,745	3,771	4,634	4,690	1,207	5,225	5,526
502 Higher education	1,232	1,385	1,433	1,447	1,532	1,349	2,050	2,663	739	3,474	3,375
503 Research and general education aids	330	521	520	523	668	867	947	774	186	1,100	1,223
504 Training and employment	1,560	1,602	1,952	2,894	3,283	2,910	4,063	6,288	1,912	7,886	11,693
505 Other labor services	122	135	157	184	202	219	259	301	83	382	421
506 Social services	908	1,148	1,449	2,694	2,455	2,496	3,301	3,456	887	4,138	4,241
Deductions for offsetting receipts	−10	−10	−10	−11	−10	−13	−5	−5	−1	−5	−6
Total education, training, employment, and social services	**6,871**	**7,888**	**9,045**	**11,694**	**11,874**	**11,598**	**15,248**	**18,167**	**5,013**	**22,199**	**26,473**
550 Health:											
551 Health care services	9,537	10,648	12,107	14,538	15,476	18,502	23,405	28,655	7,556	34,682	39,721
552 Health research and education	1,459	1,577	1,687	1,952	2,272	2,334	2,677	3,086	934	2,784	3,150
553 Prevention and control of health problems	348	362	459	541	638	750	883	963	251	1,098	1,117
554 Health planning and construction	415	469	465	443	449	494	687	752	−20	949	505
555 General health financing assistance	------	------	------	------	------	------	------	------	------	------	------
Deductions for offsetting receipts	−2	−6	−2	−3	−3	−6	−5	−8	−1	−8	−8
Total health	**11,758**	**13,051**	**14,716**	**17,471**	**18,832**	**22,074**	**27,647**	**33,448**	**8,720**	**39,505**	**44,485**
600 Income security:											
601 General retirement and disability insurance	28,288	31,303	37,485	41,966	51,684	58,613	69,383	77,173	20,930	89,880	95,910
602 Federal employee retirement and disability	1,732	2,688	3,191	3,789	4,500	5,645	6,980	8,174	2,319	9,662	11,094
603 Unemployment insurance	2,583	3,364	6,169	7,076	5,356	6,065	13,459	19,452	3,994	15,870	13,110
604 Public assistance and other income supplements	4,679	5,712	8,580	11,081	11,419	14,108	18,783	22,609	5,553	26,161	26,435
Deductions for offsetting receipts	−1	−2	−2	−2	−2	−*	−1	−1	−*	−*	−*
Total income security	**37,281**	**43,066**	**55,423**	**63,911**	**72,958**	**84,431**	**108,605**	**127,406**	**32,796**	**141,573**	**146,549**

[illegible] security for veterans	5,036	5,546	5,966	6,344	6,533	6,789	7,860	8,350	2,082	9,107	9,603
702 Veterans education, training, and rehabilitation	701	1,015	1,659	1,960	2,801	3,249	4,593	5,531	784	4,138	3,783
703 Hospital and medical care for veterans	1,564	1,800	2,036	2,425	2,711	3,006	3,665	4,046	1,039	4,851	5,135
704 Veterans housing	102	54	−179	−317	−381	−15	24	−72	−50	−271	21
705 Other veterans benefits and services	239	263	296	320	350	359	458	578	110	565	603
Deductions for offsetting receipts	−2	−2	−2	−2	−2	−2	−2	−2	−1	−2	−2
Total veterans benefits and services	**7,640**	**8,677**	**9,776**	**10,730**	**12,013**	**13,386**	**16,597**	**18,432**	**3,962**	**18,388**	**19,143**
750 Law Enforcement and Justice:											
751 Federal law enforcement and prosecution	553	672	821	971	1,168	1,291	1,593	1,852	529	2,135	2,301
752 Federal judicial activities	112	134	146	172	188	204	279	313	83	387	423
753 Federal correctional and rehabilitative activities	71	88	104	128	158	202	226	238	64	290	327
754 Law enforcement assistance	29	65	233	380	624	770	853	921	213	899	817
Deductions for offsetting receipts	−3	−6	−6	−2	−7	−5	−9	−4	−31	−6	−6
Total law enforcement and justice	**761**	**952**	**1,299**	**1,650**	**2,131**	**2,462**	**2,942**	**3,320**	**859**	**3,705**	**3,862**
800 General government:											
801 Legislative functions	254	303	342	404	438	521	588	677	182	868	914
802 Executive direction and management	25	30	38	59	72	117	63	68	16	84	83
803 Central fiscal operations	808	934	1,013	1,183	1,209	1,329	1,752	1,798	429	2,002	2,117
804 General property and records management	587	616	637	719	910	1,030	418	95	67	329	359
805 Central personnel management	38	44	51	58	67	74	88	107	25	110	111
806 Other general government	88	158	218	189	221	419	472	454	228	545	509
Deductions for offsetting receipts	−151	−145	−141	−146	−235	−164	−292	−272	−69	−184	−152
Total general government	**1,649**	**1,940**	**2,159**	**2,466**	**2,682**	**3,327**	**3,089**	**2,927**	**878**	**3,754**	**3,941**
850 Revenue sharing and general purpose fiscal assistance:											
851 General revenue sharing	-------	-------	-------	-------	6,636	6,106	6,130	6,240	1,588	6,783	6,822
852 Other general purpose fiscal assistance	365	451	488	531	586	640	875	879	436	3,070	2,885
Total revenue sharing and general purpose fiscal assistance	**365**	**451**	**488**	**531**	**7,222**	**6,746**	**7,005**	**7,119**	**2,024**	**9,853**	**9,707**

See footnotes at end of table.

Table 12. **BUDGET OUTLAYS BY FUNCTION, 1969-78** (in millions of dollars)—**Continued**

Function	Actual 1969	1970	1971	1972	1973	1974	1975	1976	TQ	Estimate 1977	1978
900 Interest:											
901 Interest on the public debt	16,588	19,304	20,959	21,849	24,167	29,319	32,665	37,063	8,102	42,300	46,800
902 Other interest	−796	−992	−1,350	−1,267	−1,355	−1,247	−1,691	−2,474	−856	−4,052	−5,015
Total interest	**15,793**	**18,312**	**19,609**	**20,582**	**22,813**	**28,072**	**30,974**	**34,589**	**7,246**	**38,248**	**41,785**
Allowances:											
Civilian agency pay raises	------	------	------	------	------	------	------	------	------	------	1,151
Contingencies for:											
Relatively uncontrollable programs	------	------	------	------	------	------	------	------	------	------	------
Other requirements	------	------	------	------	------	------	------	------	------	------	1,500
Total allowances	------	------	------	------	------	------	------	------	------	------	**2,651**
950 Undistributed offsetting receipts:											
951 Employer share, employee retirement	−2,018	−2,444	−2,611	−2,768	−2,927	−3,319	−3,980	−4,242	−985	−4,591	−4,653
952 Interest received by trust funds	−3,099	−3,936	−4,765	−5,089	−5,436	−6,583	−7,667	−7,800	−270	−8,176	−8,607
953 Rents and royalties on the Outer Continental Shelf	−428	−187	−1,051	−279	−3,956	−6,748	−2,428	−2,662	−1,311	−2,300	−3,400
Total undistributed offsetting receipts	**−5,545**	**−6,567**	**−8,427**	**−8,137**	**−12,318**	**−16,651**	**−14,075**	**−14,704**	**−2,567**	**−15,067**	**−16,660**
Total budget outlays [2]	**184,548**	**196,588**	**211,425**	**232,021**	**247,074**	**269,620**	**326,105**	**366,466**	**94,746**	**417,417**	**459,373**

*$500 thousand or less.

[1] Includes allowances for civilian and military pay raises for Department of Defense.

[2] Consists of:

	Actual *1969*	*1970*	*1971*	*1972*	*1973*	*1974*	*1975*	*1976*	*TQ*	*Estimate* *1977*	*1978*
Federal funds	148,811	156,301	163,651	178,104	186,951	199,920	240,031	269,969	65,106	309,501	337,757
Trust funds	43,284	49,065	59,361	67,073	81,447	90,833	111,171	131,286	34,023	144,557	157,596
Interfund transactions	−7,547	−8,778	−11,586	−13,156	−21,325	−21,133	−25,098	−34,789	−4,383	−36,641	−35,980

Table 13. **FEDERAL FINANCES AND THE GROSS NATIONAL PRODUCT, 1954–78** (dollar amounts in billions)

Fiscal year	Gross national product	Budget receipts		Outlays [1]		Federal debt, end of year			
		Amount	Percent of GNP	Unified budget		Total		Held by the public	
				Amount	Percent of GNP	Amount	Percent of GNP	Amount	Percent of GNP
1954	$363.6	$69.7	19.2	$70.9	19.4	$270.8	74.5	$224.5	61.7
1955	380.0	65.5	17.2	68.5	18.0	274.4	72.2	226.6	59.6
1956	411.0	74.5	18.1	70.5	17.1	272.8	66.4	222.2	54.1
1957	432.7	80.0	18.5	76.7	17.7	272.4	63.0	219.4	50.7
1958	442.1	79.6	18.0	82.6	18.7	279.7	63.3	226.4	51.2
1959	473.3	79.2	16.7	92.1	19.5	287.8	60.8	235.0	49.7
1960	497.3	92.5	18.6	92.2	18.5	290.9	58.5	237.2	47.7
1961	508.3	94.4	18.6	97.8	19.2	292.9	57.6	238.6	46.9
1962	546.9	99.7	18.2	106.8	19.5	303.3	55.5	248.4	45.4
1963	576.3	106.6	18.5	111.3	19.3	310.8	53.9	254.5	44.2
1964	616.2	112.7	18.3	118.6	19.2	316.8	51.4	257.6	41.8
1965	657.1	116.8	17.8	118.4	18.0	323.2	49.2	261.6	39.8
1966	721.1	130.9	18.1	134.7	18.7	329.5	45.7	264.7	36.7
1967	774.4	149.6	19.3	158.3	20.4	341.3	44.1	267.5	34.5
1968	829.9	153.7	18.5	178.8	21.5	369.8	44.6	290.6	35.0
1969	903.7	187.8	20.8	184.5	20.4	367.1	40.6	279.5	30.9
1970	959.0	193.7	20.2	196.6	20.5	382.6	39.9	284.9	29.7
1971	1,019.3	188.4	18.5	211.4	20.7	409.5	40.2	304.3	29.9
1972	1,110.5	208.6	18.8	232.0	20.9	437.3	39.4	323.8	29.2
1973	1,237.5	232.2	18.8	247.1	19.9	468.4	37.9	343.0	27.7
1974	1,360.9	264.9	19.5	269.6	19.8	486.2	35.7	346.1	25.4
1975	1,450.6	281.0	19.8	326.1	22.4	544.1	37.5	396.9	27.4
1976	1,609.5	300.0	18.6	366.5	22.8	631.9	39.3	480.3	29.8
1977 estimate	1,830.2	349.4	19.1	417.4	22.8	727.0	39.7	571.3	31.2
1978 estimate	2,047.8	401.6	19.6	459.4	22.4	802.4	39.2	637.1	31.1

[1] The 1972–76 data have been revised to include the Export-Import Bank in the unified budget.

Table 14. **COMPOSITION OF BUDGET OUTLAYS IN CURRENT AND CONSTANT (FISCAL YEAR 1972) PRICES: 1955-78**

(In billions of dollars)

Fiscal year	Current prices						Constant (fiscal year 1972) prices					
			Nondefense						Nondefense			
	Total outlays	National defense	Total non-defense	Payments for individuals	Net interest	All other	Total outlays	National defense	Total non-defense	Payments for individuals	Net interest	All other
1955	68.5	39.9	28.6	13.0	4.8	10.8	134.3	75.9	58.5	19.9	17.7	20.9
1956	70.5	39.8	30.7	13.8	5.1	11.8	133.0	73.0	60.0	21.2	16.9	22.0
1957	76.7	42.3	34.5	15.6	5.4	13.5	137.2	74.0	63.2	23.2	16.1	23.9
1958	82.6	43.8	38.8	19.4	5.6	13.7	141.9	74.1	67.7	28.0	16.2	23.6
1959	92.1	45.9	46.2	21.2	5.8	19.2	153.9	75.3	78.7	30.1	16.5	32.1
1960	92.2	45.2	47.0	22.9	6.9	17.2	150.8	73.9	76.9	32.1	16.3	28.5
1961	97.8	46.6	51.2	25.9	6.7	18.6	157.1	74.8	82.3	35.8	16.2	30.3
1962	106.8	50.4	56.4	27.1	6.9	22.4	168.7	79.3	89.4	37.1	16.7	35.7
1963	111.3	51.5	59.8	28.7	7.7	23.4	170.7	79.0	91.7	38.7	16.8	36.2
1964	118.6	52.7	65.8	29.7	8.2	27.9	177.4	78.8	98.6	39.7	16.8	42.2
1965	118.4	48.6	69.8	30.4	8.6	30.8	173.3	71.0	102.3	40.1	16.7	45.5
1966	134.7	55.9	78.8	34.3	9.4	35.1	187.9	77.7	110.2	44.2	16.5	49.6
1967	158.3	69.1	89.2	40.1	10.3	38.8	212.1	93.2	118.9	50.1	16.1	52.7
1968	178.8	79.4	99.4	45.9	11.1	42.4	229.5	102.2	127.3	55.6	16.9	54.8
1969	184.5	80.2	104.3	52.8	12.7	38.9	223.1	98.8	124.3	60.9	15.5	47.8
1970	196.6	79.3	117.3	59.8	14.4	43.1	220.8	91.1	129.7	65.1	15.0	49.6
1971	211.4	76.8	134.6	74.5	14.8	45.2	223.0	82.3	140.8	77.2	15.2	48.3
1972	232.0	77.4	154.7	85.3	15.5	53.9	232.0	77.4	154.7	85.3	15.5	53.9
1973	247.1	75.1	172.0	95.9	17.4	58.7	233.2	70.5	162.7	92.2	15.4	55.1
1974	269.6	78.6	191.1	111.1	21.5	58.5	231.4	68.3	163.1	98.0	14.3	50.7
1975	326.1	86.6	239.5	142.6	23.3	73.6	251.9	67.0	184.8	113.3	14.6	57.0
1976	366.5	90.0	276.5	167.3	26.8	82.3	264.4	64.6	199.8	124.1	16.4	59.3
TQ	94.7	22.5	72.2	42.7	7.0	22.5	66.1	15.7	50.4	30.7	4.1	15.6
1977 estimate	417.4	100.1	317.3	187.3	30.1	99.9	282.5	67.0	215.4	130.6	18.0	66.8
1978 estimate	459.4	111.9	347.4	197.8	33.2	116.5	292.7	70.0	222.7	130.8	19.0	72.9

Table 15. BUDGET RECEIPTS AND OUTLAYS, 1789-1978

(In millions of dollars)

Fiscal year	Receipts	Outlays	Surplus or deficit (−)
1789-1849	1,160	1,090	+70
1850-1900	14,462	15,453	−991
1901	588	525	+63
1902	562	485	+77
1903	562	517	+45
1904	541	584	−43
1905	544	567	−23
1906	595	570	+25
1907	666	579	+87
1908	602	659	−57
1909	604	694	−89
1910	676	694	−18
1911	702	691	+11
1912	693	690	+3
1913	714	715	−*
1914	725	726	−*
1915	683	746	−63
1916	761	713	+48
1917	1,101	1,954	−853
1918	3,645	12,677	−9,032
1919	5,130	18,493	−13,363
1920	6,649	6,358	+291
1921	5,571	5,062	+509
1922	4,026	3,289	+736
1923	3,853	3,140	+713
1924	3,871	2,908	+963
1925	3,641	2,924	+717
1926	3,795	2,930	+865
1927	4,013	2,857	+1,155
1928	3,900	2,961	+939
1929	3,862	3,127	+734
1930	4,058	3,320	+738
1931	3,116	3,577	−462
1932	1,924	4,659	−2,735
1933	1,997	4,598	−2,602
1934	3,015	6,645	−3,630
1935	3,706	6,497	−2,791
1936	3,997	8,422	−4,425
1937	4,956	7,733	−2,777
1938	5,588	6,765	−1,177
1939	4,979	8,841	−3,862
1940	6,361	9,456	−3,095
1941	8,621	13,634	−5,013
1942	14,350	35,114	−20,764
1943	23,649	78,533	−54,884
1944	44,276	91,280	−47,004
1945	45,216	92,690	−47,474
1946	39,327	55,183	−15,856
1947	38,394	34,532	+3,862
1948	41,774	29,773	+12,001
1949	39,437	38,834	+603
1950	39,485	42,597	−3,112
1951	51,646	45,546	+6,100
1952	66,204	67,721	−1,517
1953	69,574	76,107	−6,533
1954	69,719	70,890	−1,170
1955	65,469	68,509	−3,041
1956	74,547	70,460	+4,087
1957	79,990	76,741	+3,249
1958	79,636	82,575	−2,939
1959	79,249	92,104	−12,855
1960	92,492	92,223	+269
1961	94,389	97,795	−3,406
1962	99,676	106,813	−7,137
1963	106,560	111,311	−4,751
1964	112,662	118,584	−5,922
1965	116,833	118,430	−1,596
1966	130,856	134,652	−3,796
1967	149,552	158,254	−8,702
1968	153,671	178,833	−25,161
1969	187,784	184,548	+3,236
1970	193,743	196,588	−2,845
1971	188,392	211,425	−23,033
1972	208,649	232,021	−23,372
1973	232,225	247,074	−14,849
1974	264,932	269,620	−4,668
1975	280,997	326,105	−45,108
1976	300,005	366,466	−66,461
TQ	81,773	94,746	−12,973
1977 est	349,377	417,417	−68,040
1978 est	401,624	459,373	−57,749

Notes.—Certain interfund transactions are excluded from receipts and outlays starting in 1932. 'or years prior to 1932 the amounts of such transactions are not significant.

Refunds of receipts are excluded from receipts and outlays starting in 1913; comparable data re not available for prior years.

Data for 1789–1939 are for the administrative budget: 1940–1978 are for the unified budget.

Starting in calendar year 1976 the Federal fiscal year was converted from a July 1–June 30 basis › an Oct. 1–Sept. 30 basis. The TQ refers to the transition quarter from July 1 to Sept. 30, 1976.

The 1972–76 data have been revised to include the Export-Import Bank in the unified budget.