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TESTIMONY OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE

Mr. Chairman and Members of this distinguished Committee:

I appreciate this opportunity to discuss with you the President's economic and budgetary plans for 1979 and 1980.

The American economy is at a critical juncture. Since the deep recession of 1974-75, we have enjoyed an unprecedented recovery of employment and production, but we have had less success in maintaining the value of our currency at home and abroad. This imbalance in our achievements cannot persist. Either we shall right the balance ourselves by bringing inflation under orderly control, or events will reassert equilibrium for us, by bringing the economic recovery itself to a disorderly close. There is no doubt which alternative best serves the public interest. The only question is whether we in Washington, subject as we all are to the usual political cross-currents, can find the will to choose and hold to the correct path. The stakes are high. In deciding upon this budget, the new Congress will largely determine whether or not we enter the 1980's with a firm foundation for long term prosperity.

We reach this decision point after several years of truly exceptional economic performance. Since President Carter assumed office, the gains in employment and output have outpaced even optimistic expectations:

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- Over 7 million new jobs have been created. This is the largest gain in employment during any two year period in our history, and the ratio of employed persons to the working-age population is at an all-time high.

- The number of unemployed has been cut by more than 1 million persons, and the rate of unemployment has been reduced to below 6 percent. By way of reference, the rate peaked at 9 percent in 1975 and was still close to 8 percent at the end of 1976.

- Real output has expanded by 10 percent, and industrial production has risen by 13 percent.

- Real disposable personal income -- income after taxes and corrected for inflation -- has risen by almost 9 percent. Corporate profits have also increased -- by more than a third -- even after adjusting for the rise in replacement costs.

But all of these achievements now stand threatened by inflation. Unless we assure the integrity of our currency, both at home and abroad, the economy's forward progress will reach the familiar dead-end of recession and financial dislocation. We can avoid these evils, but only if we are prepared now, and for an extended period, to move the fight against inflation to the top of our list of economic priorities.

That is the message of the President's budget. I believe the American people are prepared to respond to that message -- to join earnestly in a common effort to re-secure the fundamentals of economic progress for the next decade. I do not sense that the people share the superficial view that this budget lacks interest because it is short on new ideas for spending their tax dollars. They realize that in its very spareness the budget constitutes a new initiative of major importance: an initiative to assert responsible control over our economic destiny.

I. The inflation problem

Over the 1970's, inflation has posed a critical threat to economic progress throughout North America, Europe, and Japan. It has made all of our other problems much worse. In some countries, inflation has compromised political

stability and democratic procedures. More than once, it has seriously shaken the international monetary system. Everywhere it has retarded economic growth and social progress. Inflation has proved to be far more destructive of prosperity, and far more intractable, than any of us would have imagined possible ten years ago.

As the decade comes to a close, however, we have learned that inflation is not like death and taxes: we can rid ourselves of it. In 1974, Japan suffered a 22-1/2 percent rate of inflation; the Japanese inflation rate is currently running at 4 percent. Similarly, Germany has reduced its inflation rate from 7 percent to 2-1/2 percent over the past 4 years, and the British brought their inflation rate down from 24 percent to 8-1/2 percent between 1975 and 1978.

That is cause for hope. But it is also reason for impatience about our own experience. The inflation record of the United States has been less than admirable. The dollar's buying power has been cut in half since 1967. In the 1970's, inflation here has rarely gone into the double digits -- but it has averaged 6-3/4 percent. Last year, the inflation rate experienced a disturbing acceleration. At the end of 1978 the CPI was 9 percent higher than at the end of 1977. This constituted an increase of more than 2 percentage points over the previous year's inflation rate.

The roots of our inflation problem are numerous and deep. There is no one cause for the problem, and we cannot expect to solve it either quickly or with any single panacea.

In the spring of last year, the President moved the fight against inflation ahead of all other objectives and began to mobilize the full arsenal of weapons necessary to win the fight.

During the spring and summer of 1978, the President worked with the Congress to reduce the FY 1979 budget deficit to less than $38 billion. In late October and November, the President added important new weapons to the arsenal. He set a target of $30 billion or less for the FY 1980 budget deficit; he announced that the Federal Reserve Board would take strong steps to contain credit expansion; he arranged with Germany, Japan, and Switzerland a far-reaching program to stabilize and strengthen the dollar

against inflation to win temporary victories. Our goal is not a momentary pause in the wage-price spiral, but an economy securely settled on a path of long-term price stability and sustainable progress in growth and employment. This will require a long-term commitment to hold down the government's claims on the economy's real and financial resources, and a long-term commitment to keep the supply of dollars from validating excessive demands.

The President's FY 1980 budget sets an example of restraint for the economy:

- Federal spending will be nearly frozen in real terms. After adjusting for inflation, Federal outlays in 1979 will grow by only 0.3 percent and those of 1980 will be only 0.7 percent higher than in 1979. These are the smallest increases in five years and far below the 3.2 percent average increase for the previous 8 years of this decade.

- Federal spending will be held to levels that absorb a smaller share of total output. Outlays in 1980 will be down to 21 percent of GNP, compared with the recent high of 22.6 percent in 1976.

- The Federal deficit will be below $30 billion for the first time in five years and will be barely more than 1 percent of GNP.

- Federal employment will actually be reduced. Civilian employment in the government will be less by the end of 1980 than it was when President Carter took office.

To achieve this degree of budgetary restraint is a major feat. Our long-term defense needs are substantially dictated by foreign dangers beyond our control. About three-quarters of federal budget outlays -- over $400 billion of the $531.6 billion -- are mandated by continuing statutes or obligations which are nearly impossible to alter in the short term. About one-half of budget outlays -- over $250 billion -- represent transfer payments for individuals, which are usually indexed to the rate of inflation, so that total spending has a nearly inexorable tendency to rise in times of inflation. This leaves only a relatively small portion of the budget susceptible to practical control on a year-to-year basis by the President and the Congress.

In his budget the President has taken great pains to allocate the needed cutbacks fairly and sensibly among the many competing public demands, showing particular regard for those groups most in need of federal help and support. But make no mistake: The budget makes a major contribution to the poor and the disadvantaged in its very restraint, its very emphasis on fighting inflation. For it is society's most vulnerable members that suffer most grievously from inflation.

Fiscal austerity must be complemented by monetary restraint until the inflation problem is brought firmly under control. As Chairman Miller stated last week: "The Administration's wage-price standards and other anti-inflation initiatives can be successful only if they are backed up by macro-economic policies of restraint...We must find the courage to adhere for a sustained period to the course of policy we have charted."

Innovations in our financial system are keeping monetary restraint from concentrating its impact predominantly on the housing industry, which in previous cycles was the earliest victim of increased credit stringency. The impact of monetary restraint is now less discriminatory, but it remains a powerful and necessary component of our anti-inflation arsenal. And it is being used.

Our tight budgetary policies are easing the task of the monetary authorities. With a reduced deficit, and with off-budget financing activities being monitored more closely, Federal demands on financial markets will be substantially reduced. Federal borrowing from the public this year and next will be declining both absolutely and relative to the total amount of credit raised in financial markets. In 1976, the federal government accounted for over a fifth of total credit demands. This year, federal borrowing will be less than a tenth of the total, and the share of credit absorbed by the government will decline further in 1980. This means that monetary aggregates can be restrained without choking off essential flows of credit to the private sector.

III. Sluggish productivity growth

Another major source of our inflation problem is sluggish productivity growth -- a low rate of increase in real output per hour of work. On this criterion, we have been finishing dead last among industrial nations throughout most of the 1970's.

Productivity growth is the fulcrum between wage inflation and price inflation. Over the long term, one can usually approximate the figure for price inflation by subtracting productivity growth from the rate of wage inflation. From 1948 to 1968, productivity in the private non-farm business sector rose about 2-1/2 percent a year; labor compensation rose at 5 percent; and price inflation averaged below 3 percent. Over the last ten years however, productivity growth in the private non-farm business sector has averaged only 1-1/2 percent, and last year it fell to an abysmal 0.8 percent. This means that average wage increases and price inflation now run at nearly the same rate: last year, for instance, compensation per hour (wages plus fringes) rose by about 9-3/4 percent; with productivity growth depressed, price inflation tracked right along at about 9 percent.

To improve productivity growth requires a long term effort to increase our investment in productive resources and to refrain from imposing excessive regulatory burdens upon the private sector. Last year's tax bill, involving substantial incentives for investment, will help. The President's new program for reviewing regulatory costs and benefits will help.

But it will take persistent policy attention over a number of years to return productivity growth to the high rates that made life so cheerful for economic advisers in the 1960's. Until then, price inflation will parallel average wage inflation: to bring down price inflation, we must bring down wage inflation, and vice versa.

IV. The momentum of the wage-price sprial

Central to our long-term inflation problem is the sheer, self-reinforcing momentum of the wage-price spiral.

Inflation persists because everyone expects it to persist. Expecting high inflation, business sets high prices, labor demands high wages -- and we thereby generate

precisely the high inflation that was expected.

The wage-price spiral is enormously stubborn. Demand restraint can have some effect on it, and is clearly a necessary part of any cure; but, acting alone, demand restraint works its cure quite slowly and harshly. The U.S. inflation rate in the 1970's has declined with painful slowness even during periods of great slack in labor and product markets. Even when aggregate demand is sharply cut back, business and labor continue for a substantial period to act upon deeply ingrained expectations of high inflation. The inflationary momentum persists and, while it does, the decline in demand delivers its impact on the only remaining targets: employment and real growth. It is only after a considerable period of demand restraint that inflationary expectations finally begin adjusting to the changed economic conditions.

To succeed in reducing inflation, we must learn patience, but we must also seek to speed up the response of wages and prices to conditions of demand restraint. Every advanced nation has recognized this. Each has established its own particular procedures and institutions for braking wage-price momentum -- for overriding unrealistic inflationary expectations -- so that demand restraint can reduce inflation without socially wasteful delays.

It is for this purpose that the President promulgated voluntary wage-price standards last October. These standards describe a path for wages and prices consistent with the general moderation of economic activity that is assured by our application of fiscal and monetary discipline. If these standards are followed, the inflation rate will adjust downward to the slowing pace of the economy. We will avoid an unnecessary, sharp fall-off in real growth rates and an unnecessary, large increase in unemployment.

The wage-price standards are voluntary. The President strongly opposes mandatory controls. The U.S. experience with controls, and that of virtually every other nation, is that they saddle the economy with enormous bureaucracy, miles of red tape, and crippling inefficiencies. Very quickly, mandatory controls collapse under their own weight. Controls are an attempt to usurp the roles of the marketplace and the collective bargaining table in setting every price and wage throughout the economy. That's an

absurd and unnecessary project. Our purpose is merely to brake the momentum of wages and prices that is unresponsive to basic macro-economic conditions. That vital, but limited, purpose can be accomplished without excessive governnment interference in allocating resources and incomes throughout the economy.

But voluntarism raises a basic issue. It requires that everyone forego apparent short-term economic gains in exchange for long-term economic improvements of a much more substantial, general, and lasting character. Every working person has the legitimate concern that his or her compliance with the program will not be matched by others and will accordingly result in reduced real income as inflation continues beyond a 7 percent level. Wages are set for extended periods -- 6 months, a year, sometimes several years. Compliance on the wage side constitutes a relatively long-term commitment, and thus triggers a particularly acute concern about real income loss. This is the concern that drives the wage side of the wage-price spiral.

The President has proposed an innovative program for real wage insurance to meet directly this central concern of working people. The proposal would materially reduce the financial risks of compliance; it would lead to more widespread compliance, and thus to a more rapid and pronounced impact on the inflation rate.

The proposal in effect sets up an insurance contract. In this contract, we ask wage restraint from each employee group, so as to reduce inflation for the benefit of all; in return we offer to share the risk that inflation will in fact exceed the wage increase ceiling. This is a novel, but natural, response to a dilemma that has evaded solution for many years. In the overall structure of our anti-inflation policies, real wage insurance plays an important role for which there are no readily imagined substitutes.

V. The need for a strong and stable dollar

The dollar's value cannot be protected at home if it is weak abroad, and we cannot maintain its integrity abroad if it is shrinking at home. Last year, that maxim received a sharp and painful illustration. The acceleration in domestic inflation served to weaken the dollar on the foreign exchange markets, and this in turn raised the domestic price level even further -- as the cost of imported

goods rose and provided an umbrella for domestic price increases. We estimate that the dollar's depreciation last year may have added as much as one full percentage point to our inflation rate.

The President moved forcefully on November 1st to put an end to this vicious cycle. He endorsed the imposition of greater monetary restraint domestically and arranged with Germany, Switzerland and Japan a program of closely coordinated intervention in the foreign exchange markets.

The U.S. has mobilized most of the $30 billion in foreign exchange resources being used to finance our share of this effort. These funds have been obtained partly through use of U.S. reserves and partly by borrowing, including the issuance of foreign currency denominated securities.

The increase to $15 billion in the central bank swap lines with those three countries took effect immediately on announcement. Drawings on the IMF in Deutschemarks and Japanese yen, amounting to the equivalent of $2 billion and $1 billion, were made in early November. Later that month we sold about $1.4 billion equivalent in SDR's for Deutschemarks and yen. To date we have undertaken two issues of foreign currency bonds totaling the equivalent of $2.8 billion -- a DM issue of about $1.6 billion in January, and a Swiss franc issue of about $1.2 billion in January. We expect to borrow additional amounts during the fiscal year but have not yet decided upon the details of further issues.

The shift in intervention practices announced on November 1 was designed to restore order in exchange markets and a climate in which rates can respond to the improved outlook for the economic fundamentals that underpin the dollar's value. We are not attempting to peg exchange rates, nor to establish target zones, nor to impose exchange rates inconsistent with the fundamental economic and financial realities.

The initial response in the foreign exchange markets to the November 1 actions was good. From its low point on October 31 the dollar recovered on a trade-weighted basis by 12 percent by November 20. Against the DM and the yen the recovery was also 12 percent; against the Swiss franc, 18 percent. Subsequent pressures from political developments

in Iran and the OPEC decision to increase oil prices substantially were met by forceful action from monetary authorities and by the resiliency of two-way trading. The dollar has stabilized and, today, on a trade-weighted basis, the dollar is over 9 percent above the October low.

We are beginning to see a change in tone and expectations in the foreign exchange and domestic money markets. Markets have been much more orderly and better balanced, although there is still some nervousness and uncertainty. I believe we will see increased stability as our determination to persevere becomes more evident.

The United States is determined to prevent any resurgence of the kind of conditions in the foreign exchange markets which led to the actions on November 1. Our resources are very substantial, and we will not hesitate to use them as necessary to achieve our objectives. The other participants have committed their own substantial resources to those joint operations. There is, in fact, no quantitative ceiling on the total resources which the four countries are ready to use.

Other members of the IMF are also dedicated to assuring exchange market stability. The recently amended IMF Articles of Agreement provide for strengthened surveillance of members' economic policies to insure achievement of this objective.

We are prepared to consider with an open mind ideas for evolutionary change in the monetary system. What is important is that any change be an improvement and that the transitions be accomplished smoothly and in a manner which strengthens our open international trade and payments system.

To conclude this discussion of the international dimensions of our economic situation, let me stress that to keep the dollar firm, the United States must continue reducing its trade and current account deficits. The portents are hopeful on this front. Containing inflation at home will make our goods more competitive both at home and abroad. Foreign economies, and thus markets, will grow faster than our own economy in 1979 for the first time in five years, and this will provide better export opportunities.

Our trade balance showed marked improvement during 1978, and we expect this to continue. In the second and third quarter of 1978, the trade deficit narrowed to a $31-1/2 billion annual rate (balance of payments basis), some $14 billion below the rate of the preceding six months. In the fourth quarter of the year, the trade deficit averaged about $2-1/2 billion, a $30 billion annual rate. Export volumes have risen strongly since March 1978; growth in non-oil import volume has slowed down substantially. We expect continued strong export growth and a very small increase in import volume in 1979. Although the oil price rise will add about $4 billion to oil imports, the trade deficit should decline to about $25-to-28 billion for the year as a whole and, owing to our growing net invisibles surplus, the currenct account deficit could drop by about 50 percent from the $17 billion estimated for 1978.

VI. The road ahead

We are mobilizing every element of economic policy behind the fight against inflation -- fiscal policy, monetary policy, international financial policy, regulatory policy, wage-price policy, and more. None of this will work instantly; for success, we will need a long-term commitment by the entire federal government, supported by a determined nation, to keep the anti-inflation effort at the top of our list of priorities for a number of years.

This does not mean that we face a bleak future. Quite the contrary. It is only by turning firmly against the forces of inflation, and then holding our course, that we can save our economy from economic turmoil in the short run and the trap of stagflation in the long run. If we show the requisite discipline, this economy can be successfully steered, without a recession, on to a path of price stability and steadily enlarging prosperity.

I am well aware that some are forecasting a recession for 1979 or 1980. In passing, I would note three points: First, we have been hearing such forecasts for better than a year now; as the economy shows continued resiliency, the predicted recessions keep getting a rain check. Second, the recession scenarios all involve much milder and much shorter downturns than we experienced in 1974; no one sees us on the road to a serious bust. Third, with very rare exceptions, the forecasters are not suggesting that we should seek to avert a downturn by now liberalizing our fiscal or monetary policies; this could only lead to a much more severe and prolonged recession.

My major point, however, is that the path we are now pursuing need not involve a recession. We do foresee a definite slowing in the pace of real growth -- from 4-1/4 percent last year to the 2-to-2-1/2 percent range this year -- and a concommitant moderation in the pace of inflation -- from 9 percent last year to about 7-1/2 percent this year. Our projected growth rate is just about where we ought to be -- for the economy to cool itself off in a measured fashion, for inflation to turn resolutely away from the double digit range, for the trade deficit to narrow significantly, and for the dollar to firm up substantially.

Our projected moderation in inflation will come from a number of sources: the slowdown in growth itself, a fall off from last year's abnormally high rate of food price increases, the renewed stability of the dollar, a slower pace of advance for housing costs, and the discipline of the wage-price standards.

The respectable, though clearly diminished, rate of real growth in 1979 will follow from the continued resiliency and balance of the recovery. On this point, I believe, the private forecasters have been too bearish. Let me draw you attention to a number of hopeful signs.

- Momentum: Contrary to most forecasts, the economy was growing at the end of 1978 at a very strong annual rate of over 6 percent. One million new jobs were added in the last quarter of the year, three million for the year as a whole, and we entered the new year with the ratio of civilian employees to the population at a record high.

- Inventory balance: We have avoided excessive inventory accumulation throughout this recovery. Businessmen have been alert in keeping their stock-building close relative to sales. Even after adjusting for the inflationary bias in inventory/sales ratios (sales are recorded at current prices, but inventories may be carried at earlier and lower prices), these measures show reasonably good balance in most industries.

- Housing: While housing activity can be expected to taper down some next year, partly in response to the high prices of new housing and partly because of the

high level of financing costs, there is no reason to expect the sharp drop in housing activity that has been characteristic of past cyclical swings in the economy. Usually an early victim of credit stringencies, housing starts have been at over a 2 million unit rate since last winter. This strength reflects in part the strong support of the mortgage market by government housing agencies, but more importantly, the changes in financial structure that have enabled the housing sector to compete for funds in the financial markets despite sharp increases in interest rates. At the same time, social and demographic changes in family structure should continue to support strong housing demand.

- Consumer spending: The ratio of consumer debt to personal income *is* high by historical standards and bears very careful watching. But the reasons may be due more to demography than to a serious abuse of consumer credit. There are now an unusually large number of consumers in the 25- to 44-year age group. People in this age category are typically the heaviest users of credit -- they are forming households and buying homes and durable goods with the reasonable expectation of rising incomes in the future. The increasing trend toward two wage-earner households is another factor encouraging durable goods purchases often financed on credit. In view of these demographic factors, and of the fact that delinquency rates have been relatively stable over the past three years, the rise in consumer debt appears somewhat less alarming. It remains in need of careful monitoring, but a consumer-led recession does not at this point appear likely.

- Exports: Exports are finally becoming a potent source of growth, as domestic demand abates and recent exchange rate changes work to increase the foreign demand for U.S. goods. Signs of accelerated export growth are already clear--nonagricultural exports in the latest three months, September-November, increased by more than 20 percent from levels of six months earlier.

- Investments: Signs here are more mixed. The recent surveys indicate somewhat slower real growth for 1979 in business fixed investment, compared to the

past two years. However, other advance signs of capital spending, such as new orders for capital goods and construction contract awards, indicate continued strength in this vital area. Our attack on inflation requires that we accelerate the extremely slow pace of productivity advance, and this means we need increased capital formation, to upgrade and modernize our capital stock. This was a primary emphasis in last year's tax bill, and I expect its enactment will help this sector toward at least moderate, continued advance in the coming year.

Taken in sum, this evidence points to a pronounced but orderly easing of the economy's advance; it does not point to an actual reversal. Obviously, all economic forecasts leave a great deal to be desired, but the available evidence does not justify a gloomy view of our prospects.

VII. Budget issues of particular Treasury concern

Mr. Chairman, at this point I would like to mention briefly four budget issues of particular concern to the Treasury.

a. Real wage insurance

This innovative proposal plays a key role in the President's anti-inflation program. The proposal involves a tax credit, keyed to the excess of inflation over 7 percent, for workers in groups complying with the 7 percent wage standard.

We have budgeted this tax credit proposal at $2.5 billion for FY 1980 -- $2.3 billion in revenue costs and $0.2 billion in outlays (for the refundable portion of the credit).

The program's cost varies directly with the number of employees complying with the wage standard and inversely with the 1979 inflation rate. Because high compliance produces lower inflation, the program's costs are to a large extent self-limiting. We have assumed a moderate rate of wage standard compliance -- 47 million workers out of 87 million potentially eligible for the program. Our inflation estimate is 7.5 percent for the relevant period, October-November 1979 over October-November 1978. With 100 percent compliance, the inflation estimate would be lower, and the program cost would be zero.

The program involves a very modest cost for a significant impact on inflation.

b. Targeted fiscal assistance and countercyclical assistance

The Administration will propose a two-part targeted fiscal assistance and anti-recession assistance program. Part one involves a transitional fiscal assistance program carefully aimed at 500 or so local governments that have not fully recovered from the 1974-1975 recession. To ease these needy governments from the previous funding received under the anti-recession program, the new program will provide $250 million in FY 1979 and $150 million in FY 1980. Part two involves a separate, standby countercyclical assistance program to provide assistance to State and local governments in the event of a recession. The trigger level on unemployment rates exceeds current economic assumptions, and no outlays are expected for the part two program in 1980.

c. The multilateral development banks

This year we are requesting budgetary authority for our participation in all the multilateral development banks, and approval of authorizations for our participation in the replenishments of the Asian Development Fund and the African Development Fund, and in the increase in resources of the Inter-American Development Bank.

These institutions are today the main source of official development assistance throughout the world. Such assistance is vital to the economic growth and the political stability of many developing countries. By funnelling development assistance through these institutions, we serve our own economic and foreign policy interests in several very concrete ways:

- We assure broader markets for our exports and thus a stronger dollar and a stronger U.S. economy. The non-OPEC developing countries purchase about one-fourth of our exports, supporting over 1 million jobs in this country.

- We assure that our money will be spent on projects that have been expertly designed for cost-effectiveness. The various banks and funds are

central repositories of this expertise, and they exercise an objective and demanding economic scruntiny over the projects they finance.

. We assure that our money will go to those most in need. The multilateral banks and funds have put ever increasing stress on projects that reach the poorest people in the developing nations.

. We get maximum leverage for our money. Other countries contribute three dollars for every dollar we provide. In addition, backed by callable capital which does not involve any U.S. budgetary outlay, the banks borrow extensively from the world's private capital markets. Ninety percent of their ordinary capital resources are now raised in this manner, and we expect this percentage to increase further in the future.

For this fiscal year, we are requesting total budgetary authority of $3,624.9 million for the multilateral development banks. Of this, 1,842.6 million represents paid-in contributions, which involve a budgetary impact. The rest of the request is for callable capital, which serves as a guarantee for the banks' borrowings in private capital markets, but involves no budgetary outlay, and would be called only in the highly unlikely event of massive default on the part of a number of the banks' developing country borrowers.

The request for each development institution is as follows:

($ Millions)

IDA	IBRD	IFC	IDB		ADB		AFDF	TOTAL
			Capital	FSO	Capital	ADF		
1092.0	1025.8	33.4	687.3	325.3	248.2	171.3	41.7	3624.9

The request includes $989 million from a shortfall in our FY 1979 request involving previously authorized amounts, of which approximately half is for callable capital for the World Bank.

The paid-in amounts requested -- $1,842.6 million -- constitute a significant reduction --16 percent-- from the paid-in amounts requested for FY 1979. This reduction

reflects the Administration's effort to keep the budget as stringent as possible, while still meeting our vital economic interests and our international obligations.

Restraint will also characterize the authorization proposals which the Administration expects to submit during the course of FY 1980 for U.S. participation in the resource replenishments of the Asian Development Fund and the African Development Fund and in the increase in resources for the Inter-American Development Bank. For example, contributions for U.S. participation in the IDB will be smaller over the four-year life of the new replenishment (1979-1982) than was the case in the previous replenishment period (1975-1978).

d. Statutory debt limit

The Administration believes that the public debt would be more effectively controlled and more efficently managed by tying the debt limit to the new Congressional budget process. I hope that we can work together to devise an acceptable way to do this.

The present statutory debt limit is not an effective way for Congress to control the debt. In fact, the debt limit may actually divert public attention from the real issue -- control over the Federal budget. The increase in the debt each year is simply the result of earlier decisions by the Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional control over budget outlays, receipts, and thus the public debt. This new budget process assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

The statutory limitation on the public debt occasionally has interfered with the efficient financing of the Federal Government and has actually resulted in increased cost to the taxpayer. For example, when the temporary debt limit expired on September 30, 1977, and new legislation was not enacted on the new debt limit until October 4, and again when the limit lapsed from July 31, 1978 to August 3, 1978, Treasury was required in the interim periods to suspend the sale of savings bonds and other public debt securities. The suspension of savings bonds

sales, in particular, resulted in considerable public confusion, additional costs to the Government, and a loss of public confidence in the management of the government's finances.

VIII. Conclusion

I began by noting that the American economy is at a critical juncture. Let me close with a word of guarded optimism.

It has been just three months since the President took a series of bold and coordinated steps in fiscal, monetary, exchange rate, and wage-price policy. These steps have set in motion broad and hopeful trends throughout the economy.

The dollar has rallied by more than 9 percent against OECD currencies, and the stock market has gained substantially, since the President acted. Financial leaders, both here and abroad, now recognize that this government is determined to see the inflation fight through to a successful conclusion. It is no longer the smart bet to wager against the prospects of the American economy. The recovery remains balanced and resilient. The American people have ignored the cynics and have shown a genuine receptivity to a common, voluntary effort to restrain wages and prices.

All this adds up to strong evidence that our economy can indeed be steered to a deflationary path without dislocation, turmoil, and recession.

These hopeful signs do not of course mean we have won this fight, but they give us a genuine chance to win it -- if we can retain the momentum.

What is needed now, to maintain our momentum, is a clear sign that the Congress too is committed to securing the foundations of our prosperity for the decade ahead. I look forward to working with you on this important enterprise.

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TREASURY TO START ANTIDUMPING INVESTIGATION ON 45 R.P.M. ADAPTORS FROM THE UNITED KINGDOM

The Treasury Department today said it will start an antidumping investigation of imports of 45 R.P.M. adaptors from the United Kingdom.

Treasury's announcement followed summary investigations conducted by the U. S. Customs Service after receipt of a petition filed by Aldshir Manufacturing Co., Inc., of Tuckahoe, New York, alleging that firms in the United Kingdom are dumping 45 R.P.M. adaptors in the United States.

This case is simultaneously being referred to the U. S. International Trade Commission. Should the Commission find, within 30 days, no reasonable indication of injury or likelihood of injury to a domestic industry, the investigation will be terminated. Otherwise, the Treasury will continue its investigation. A tentative determination would then be made by April 30, 1979.

The petition alleges that imports of 45 R.P.M. adaptors are being sold in the United States at "less than fair value." (Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market.)

If sales at less than fair value are determined by Treasury, the U. S. International Trade Commission will subsequently decide whether they are injuring or likely to injure a domestic industry. (Both sales at less than fair value and injury must be determined before a dumping finding is reached. If dumping is found, a special antidumping duty is imposed equal to the difference between the price of the merchandise at home or in third countries and the price to the United States.)

Notice of the start of this investigation will appear in the Federal Register of February 2, 1979.

Imports of 45 R.P.M. adaptors in the first ten months of 1978 were valued at $57,000.

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FOR IMMEDIATE RELEASE
February 1, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES FIRST DETERMINATION
IN ANTIDUMPING INVESTIGATION BEGUN AS A
RESULT OF STEEL TRIGGER PRICE MECHANISM

The Treasury Department today announced its tentative determination that exports of carbon steel plate from Poland produced by Stahlexport Przedsiebiorstwoa (Stahlexport) are being sold at "less than fair value" in the United States.

Accordingly, appraisement of shipments will be withheld and bonds sufficient to cover potential dumping duties of 20 percent will be required of importers as of February 5, 1979.

This investigation, conducted under the Antidumping Act, is one of two pending "fast track" investigations initiated on the basis of information collected through the Trigger Price Mechanism (TPM), created to monitor imports of steel mill products. A determination with respect to the other investigation, involving carbon steel plate from Taiwan produced by China Steel Corporation, has not yet been made but is expected shortly, also on an expedited basis.

Both of these "fast track" investigations were initiated in October 1978 after evidence had been developed indicating that each company was selling significant quantities of carbon steel plate to the United States at prices significantly less than the applicable trigger prices, and, according to information developed in administering the TPM, apparently at less than "fair value."

The investigation conducted to date indicates that sales of carbon steel plate by Stahlexport to the United States were made at less than "fair value" with margins as high as 44 percent.

Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market or to third countries. However, the Antidumping Act does not permit the use of prices in either the home market or to third countries when the country in which the product was manufactured is a state-controlled economy, such as Poland. In those cases, fair value is determined from the home market prices or prices to third countries of that product manufactured in a market

economy country at a comparable stage of economic development. For purposes of this action, the Treasury Department used home market prices of carbon steel plate in Spain, a market economy considered to be at a stage of development comparable to Poland.

Under the Antidumping Act, the Secretary of the Treasury is required to withhold appraisement and obtain bonds to cover potential duties when he has reason to believe that sales at less than fair value are taking place. Withholding of appraisement means that valuation for Customs duty purposes of goods imported after the date of the tentative determination is suspended until completion of the investigation. This is to permit assessment of any dumping duties that are ultimately imposed on those imports.

If a final determination of sales at less than fair value is made, the case will be referred to the U. S. International Trade Commission to determine whether an American industry is being or is likely to be injured by such sales. Both "sales at less than fair value" and "injury" must be found to exist before a dumping finding is entered.

Notice of this action will appear in the Federal Register of February 5, 1979.

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Contact: Alvin M. Hattal
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TREASURY DEPARTMENT ANNOUNCES WITHHOLDING OF APPRAISEMENT AND DETERMINATION OF SALES AT LESS THAN FAIR VALUE WITH RESPECT TO PERCHLORETHYLENE FROM BELGIUM, FRANCE, AND ITALY

The Treasury Department today said it has determined that perchlorethylene imported from Belgium, France, and Italy is being sold in the United States at "less than fair value." The case is being referred to the U.S. International Trade Commission, which must decide within 90 days whether a U.S. industry is being, or is likely to be, injured by these sales.

If the decision of the Commission is affirmative, dumping duties will be collected on sales found to be at less than fair value. (Sales at less than fair value generally take place when imported merchandise is sold in the United States for less than in the home market or to third countries.)

Under the Antidumping Act, the Secretary of the Treasury is required to withhold appraisement when he has reason to believe that sales at less than fair value are occurring. (Withholding of appraisement means that the valuation for Customs duty purposes of goods imported is suspended. This is to permit the assessment of any dumping duties as appropriately determined on those imports.)

Appraisement will be withheld for three months on imports of perchlorethylene from Belgium, France, and Italy, beginning on February 2, 1979. The weighted-average margins of sales at less than fair value in these cases were 150 percent, 47.82 percent, and 30 percent for Belgium, France, and Italy, respectively.

Interested persons were offered the opportunity to present oral and written views before this determination.

Imports of perchlorethylene from Belgium, France, and Italy during 1977 were valued at about $1.7 million for each of the countries.

Notice of this determination will appear in the Federal Register of February 2, 1979.

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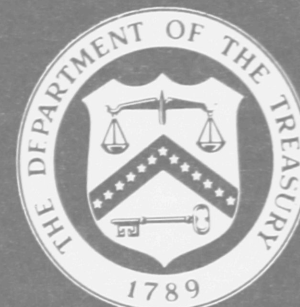

FOR IMMEDIATE RELEASE
EXPECTED AT 10 A.M. EST
MONDAY, FEBRUARY 5, 1979

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
SENATE FINANCE COMMITTEE

The International Economic Situation

In the year since I last appeared before this subcommittee, we have made considerable progress in addressing the economic problems facing the world economy.

Among these problems, the most serious were those related to the global imbalances in trade and payments associated with the oil-price increases in 1973 and 1974. The OPEC members registered enormous trade and current-account surpluses. The major industrial countries experienced a severe recession, and there were very large trade imbalances within the group. The deficits of the non-OPEC developing countries mushroomed.

Forty years earlier, the major countries responded to economic difficulties by blocking trade and restricting

capital movements. The result was massive unemployment and a decade of misery. This time the approach was different, and the costs were vastly reduced. We are now more certain that cooperation among governments in formulating and implementing consistent and responsible economic policies can be achieved. And we are now more aware of the capacity of international capital markets to function as shock absorbers.

During the past year, the global pattern of trade and payments has changed significantly. In particular, the surpluses of the OPEC members have declined sharply, while the deficits of the non-OPEC developing countries have risen only moderately. At the same time, a few large imbalances remain among the industrial countries, particularly the United States, Germany, and Japan. While the current-account deficit for the United States in 1978 was unsustainably high at around $17 billion, we are confident that our deficit in 1979 will be much smaller--by 50 percent or more. The bad news in this area is the oil-price increase announced by OPEC in December. The increase will hurt growth, inflation, and balance-of-payments adjustment prospects.

There were several noteworthy actions taken during the past year. Among them were:

-- implementation by the United States of a broad array of economic policies to establish the fundamental

economic conditions required for a strong dollar at home and abroad. Most importantly we are acting forcefully to bring inflation down through a coordinated program of fiscal austerity, monetary tightening, and voluntary wage-price restraint. In addition, we have joined with other major countries in closely coordinated direct action in the foreign exchange market to prevent any resumption of the disorders which led to the precipitate decline of the dollar last fall;

-- substantial completion of a package of agreements within the Multilateral Trade Negotiations, with final texts expected to be submitted to Congress by early April. This is, of course, a matter of great concern to the Congress, and I expect to get to know many of you a lot better while exchanging views on the subject in the months ahead;

-- the strengthening of the international monetary system by the adoption of revised Articles of Agreement for the IMF and measures to increase the IMF's ability to provide balance-of-payments financing including the establishment of the Supplementary Financing Facility, agreement on new allocations of Special Drawing Rights (SDRs) during the next

three years, and approval, subject to the necessary legislative approval by member governments, of a 50 percent increase in IMF quotas;

-- the enactment of energy legislation by the Congress which should reduce oil consumption in the United States by 500,000 barrels per day by the end of 1979. This is equivalent to $2.5 billion in annual imports at the prices recently announced by OPEC.

International Debt

In this context, I want to present our views on international debt. Last year I pointed out in these hearings that the easy distinction between creditor countries and debtor countries has become blurred. It is no longer the case that developing countries are debtors and industrial countries are creditors. Developments in the U.S. balance of payments during the past year have emphasized this point only too well.

The composition of international debt has also been changing. In the early post-war years, international debt was largely associated with short-term trade financing. In the 1960s, the composition shifted in the direction of long-term official flows as bilateral and multilateral aid programs became an important channel of international funds.

The multilateral development banks--the International Bank for Reconstruction and Development, the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank--have become the primary source of official assistance to less developed countries. In 1979, it is expected that their commitments will reach $12.5 billion and that their disbursements will amount to more than $5.5 billion. This level of lending activity has enabled the banks to play an extremely effective role in stabilizing and lengthening the overall maturities of the international debt structure of less developed countries. Following the 1973 increases in oil prices, the banks have been particularly constructive in recycling funds, raising revenues from bond issues in surplus countries and relending them for soundly-conceived projects with lengthy maturities in developing countries. The continuity of bank lending, the choice of projects, the maturities and grace periods of loans have given these countries much needed additional flexibility to carry out their development programs. The banks have also played another indirect but extremely important role in the adjustment process of these countries by recommending and assisting with necessary economic policy changes.

In the 1970s, we have also seen the emergence of medium- and long-term commercial bank lending as the major component

of international debt. From the present vantage point, we would expect private capital markets to continue to finance the bulk of the world's current-account deficits. This is likely for two reasons:

-- Official lending has grown rapidly during the past decade, but tight budgets are likely to have a restraining effect on this growth in the next decade;

-- The international banking community has demonstrated an impressive capacity to channel financial assets to deficit countries.

Compared to several years ago, we now have a considerable amount of data on international lending. The data on public borrowing by developing countries are quite detailed and comprehensive. The World Bank recently published a report on the public debt of 96 developing countries. This report puts the total public debt of these countries at $160 billion at the end of 1976--an increase of 23 percent from the year-end 1975 figure. Preliminary estimates for 1977 suggest a comparable increase.

These are very rapid rates of increase. However, these increases are directly related to the huge but temporary global imbalances I mentioned earlier, and future increases in LDC indebtedness will be more moderate as the world continues to develop a more stable pattern of trade and payments.

There are other reasons to be confident about the LDC debt situation:

-- The aggregate current-account deficit of the non-OPEC developing countries seems to be flattening out at a level of about $25 billion which does not strain the available sources of financing;

-- While net external borrowing remains at a high level, a significant part of it is in excess of current needs, and has been used to build up foreign-exchange reserves;

-- Rising exports from the non-OPEC developing countries in aggregate are keeping pace with rising debt-service payments;

-- Ample liquidity in international capital markets has enabled numerous LDCs to replace maturing debts with lower-cost, longer-term debts. For example, according to market reports, recently South Korea was able to borrow at 3/4 percent over LIBOR and Mexico borrowed at 1/2 percent over LIBOR; and

-- During the past two years, only four countries have found it necessary to reschedule debt-service payments to their official creditors (Peru, Sierra Leone, Turkey, and Zaire).

As long as world economic conditions remain favorable, there is no reason to expect that the developing-country debt situation will deteriorate.

Debts Owed to U.S. Banks

There has been considerable interest during recent years in the level and composition of U.S. banks' claims on foreigners. Last year, I was able to provide you with some new data showing overseas lending by U.S. banks as of June 30, 1977. By now, we have three semi-annual reports, the last one containing data as of June 30, 1978. The data indicate that U.S. bank lending to foreigners grew slowly in the first half of 1978. In fact, measured in real terms, there was a decline in claims on foreigners in this period. This contrasts sharply with the rate of growth experienced in the 1974-76 period which was on the order of 15-25 percent per year in current terms.

The composition of this lending is also of interest. Concern has been expressed that banks may be relying heavily on short-term deposits to fund much longer-term loans to foreigners. The data do not confirm this. About two-thirds of the $200 billion in the non-local currency claims of U.S. banks on foreigners as of June 30, 1978, had a maturity of one year or less. Another 25 percent had a maturity of 1-5

years. Only 7 percent of the claims were longer than five years.

Similarly, concerns have been expressed that the banks are too heavily exposed in loans to developing countries. Only one-fourth of U.S. banks' foreign-currency claims were on borrowers in developing countries, and only about 8 percent on public borrowers in these countries. Over 70 percent of the claims were on developed countries that are members of the OECD, OPEC countries, and off-shore banking centers. A full 50 percent of all U.S. bank claims on foreigners were on other banks.

During the past year, the Federal Reserve, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency have taken further steps to carry out their regulatory responsibilities in the area of international lending more effectively. Particularly notable is the joint system they have created for evaluating country risk associated with U.S. bank lending abroad. Bank losses on foreign loans continue to be smaller than losses on domestic loans.

Debts Owed to and Guaranteed by the U.S. Government

Judging by the mail we receive, the American taxpayer is more concerned about debts owed by foreigners to the U.S. Government than about debts owed to U.S. banks. We receive a

steady stream of letters asking about the status of World War I and World War II debts, demanding that the OPEC members pre-pay their debts, or suggesting that the best way to make the dollar stronger is to get Japan and Germany to pay off their debts to us.

We assure each correspondent that we care about these debts, and we do. We point out that all of them have resulted from programs authorized by the Congress to facilitate U.S. exports and to provide foreign assistance. We remind them that the vast majority of the post-World War II debts are paid on time. We explain how we are attempting to collect the relatively small portion of this debt which is in arrears, noting that adverse political situations have caused most of the overdue payments.

As of September 30, 1978, the total foreign debt on the books of the U.S. Government amounted to $73.2 billion. The composition of the debt is summarized in Chart One. The largest category, $45.7 billion, is post-World War II debt. About 99 percent of this debt was accounted for by long-term credit programs: aid loans to developing countries, military credits, agricultural credits, and loans from the Eximbank. The remaining 1 percent was accounted for by short-term credits and accounts receivable.

The smaller category, $27.5 billion, consists of World War I debts. I regret to say that, during the past year, we have made no progress in collecting these debts beyond the continuing repayments from Hungary and Greece. They have been carried on our books for so long that the interest now exceeds the principal--even though the interest accrues at less than 4 percent per year uncompounded.

About $1 billion in principal and $2 billion in interest was collected in the years immediately following the end of World War I. But the financial disorder in Europe in the 1920s and 1930s provided an excuse for these countries to stop payment. The unilateral termination of war reparation payments by Germany also contributed to the breakdown since most countries were owed more by Germany than they in turn owed the United States. Naturally, World War II--which has left Germany divided--did not help matters. The closest we came to settling these debts was in 1953 when the United States participated in an agreement on German external debts. In this agreement, we agreed to defer action on World War I debts "until a final general settlement of this matter". The agreement was ratified by the Senate. Candidly speaking, I believe that the settlement of these debts lies beyond the foreseeable future.

Arrearages and Delinquencies

The prospects for reducing arrearages and delinquencies are somewhat better. As of September 30, 1978, total arrearages and delinquencies on post-World War II debt stood at $612 million. I am sorry to admit that this is $21 million higher than the figure I reported to you a year ago. The increase is attributable largely to technical factors, however. It does not reflect any slackening in our effort to reduce arrearages.

Two-thirds of the increase or $14 million is accounted for by Zaire. As you will recall, the United States agreed to reschedule debt-service payments from Zaire falling due in 1976 and 1977. When implementing agreements between Zaire and the individual USG creditor agencies are signed, $23 million of the $34 million in arrearages due from Zaire will be eliminated. Another $7 million shows up in Category III.A. (Chart 2) on Turkey's account. As soon as all of the agency implementing agreements are signed pursuant to the multilateral rescheduling arrangement we took part in last May--which we expect to occur shortly--these amounts will no longer appear as arrears. Unfortunately, these increases conceal the significant progress we have made in reducing arrearages in short-term loans and accounts receivable, and in military sales and other military accounts.

You will notice in Chart 2 that the largest category of arrearages, about $200 million, relates to logistical support provided to other countries during the Korean War. While most countries to whom we provided such support have repaid the United States or are in the process of doing so, six countries have objected to paying--Colombia, Ethiopia, Greece, the Philippines, Thailand, and Turkey. The House Committee on Government Operations has recommended that Congress consider legislation to remove these debts from the records of the U.S. Treasury. The National Advisory Council on International Monetary and Financial Policies has endorsed this recommendation.

The second largest category of delinquencies is also the subject of special interest at the present time. As of September 30, 1978, there were about $108 million in arrearages on payments listed as due from the authorities on Taiwan. In addition, as footnote 1 to Chart 2 indicates, the United States is owed about $50 million in principal and interest due in connection with four Eximbank loans extended to China in 1946. There also remain some other debts which we will be discussing with the People's Republic of China at an appropriate time.

Contingent Liabilities

Before concluding, I want to say a few words about guarantees provided by U.S. Government agencies for the repayment of debts owed by foreigners to U.S. banks and other American lenders. These "contingent liabilities" represent off-budget activities with budgetary implications that are potentially quite large. The Treasury Department is particularly concerned about such programs because they have a significant impact on the allocation of funds generated by the savings and investments of private individuals and financial institutions throughout the country.

The latest Treasury Department report on contingent liabilities of the U.S. Government shows that, as of June 30, 1978, our contingent liabilities totalled $13.3 billion. These liabilities arise from guarantees provided by the Eximbank, the AID Housing Office, the Department of Defense (for military sales), and the Overseas Private Investment Corporation (OPIC). The Eximbank accounts for more than 56 percent of these contingent liabilities. There is some measurable risk involved in these guarantees because on rare occasions borrowers fail to make payments, and the guarantees are called. When this happens, the agency concerned must pay off the private lender. Usually, this is done out of the reserves of the agency. However, most payments that are missed are subsequently made to the guaranteeing agency.

There is another category of contingent liabilities that is not included in Treasury's quarterly report. This category includes the "callable capital" subscriptions of the United States to the multilateral development banks of which it is a member--the World Bank, the Inter-American Development Bank, and the Asian Development Bank. Total callable capital of all member countries, amounting to $44 billion as of September 30, 1978, stands behind the bonds floated by these banks in the international capital markets.

The chance that callable capital will ever need to be used to service the funded debt obligations of the multilateral development banks is extremely unlikely. In the first place, all of these banks have substantial resources for servicing their bonds. Paid-in capital and accumulated reserves total over $6.0 billion at the World Bank, over $1.9 billion at the IDB, and $1.5 billion at the ADB. In the second place, the countries which have borrowed from these banks have an extraordinarily good record of repayment. For example, in the more than thirty-year history of the World Bank, there has never been a loan default. Furthermore, since annual repayments from any individual borrower are only a small portion of these banks' capital and liquidity, it would take the simultaneous cessation of all loan repayments for an extended period of time by many major borrowers before a call on callable capital would be necessary. Hence, it seems most unlikely that these particular contingent liabilities will ever be drawn down.

Conclusion

I appreciate this opportunity to share with you some of our views on the international economic situation and international debt. Rather than speculate on the levels of debt that will be attained during the next twelve months, I would like to close by reflecting briefly on the three-fold virtues of international debt, which is, of course, the same thing as international credit.

First, credit facilitates trade. If trade were all conducted on a cash-and-carry basis, much less of it would take place.

Second, credit also fosters economic growth. Low-income countries that find it difficult to generate high levels of internal savings can borrow externally and thereby achieve significantly higher rates of growth than would otherwise be possible. Conversely, countries that generate excess savings are afforded opportunities to invest them profitably abroad.

Third, credit is an indispensable element of a smoothly functioning international monetary system characterized by 150 separate national currencies. Without access to credit, international payments imbalances would lead to greater exchange-rate instability, and deficit countries would try to eliminate their deficits by restricting economic growth and erecting barriers to free trade.

International credit is thus an integral part of an effectively functioning world economy. Properly managed and supervised, it facilitates the daily operation of our own economy.

Indeed, one of the great successes of the international economic policy of the United States in the postwar period has been the development and evolution of an open system of international capital and money movements. Such a system comports with our philosophy of free markets as well as with our pragmatic need for more trade, jobs, and income. We should seek its further strengthening in the years ahead.

Chart 1

TOTAL FOREIGN DEBT OUTSTANDING TO THE U.S. GOVERNMENT AS OF SEPTEMBER 30, 1978

(in $ millions)

			Outstanding
I.	World War I Indebtedness 1/		$27,463
	World War I Credit		25,541
	German World War I 2/ Indebtedness		1,922
II.	Post World War I Indebtedness on USG Credits		45,715
	A. Long-Term Credits		45,013
	Foreign Assistance & Related Acts	20,403	
	Export-Import Bank Act	11,436	
	Agriculture Trade Development & Assistance Act	7,029	
	Lend-Lease and Other War Accounts	1,336	
	Commodity Credit Corp. Export Credits	1,916	
	Other Credits	2,893	
	B. Accounts Receivable Credit		414
	Military Logistical Support	218	
	Military Sales Act	37	
	Atomic Energy Act	93	
	Other	66	
	C. Short-Term Credits		288
	Commodity Credit Corp.	288	
III.	Public and Private U.S. Claims Settled by the U.S. Government 3/		32
		GRAND TOTAL	73,210

1/ Includes interest due and unpaid
2/ Actual indebtedness is denominated in Reichsmarks.
3/ These figures are estimates only.
Includes 1966 "Freeloc" settlement with France.

Chart 2

ARREARAGES OF 90 OR MORE DAYS ON FOREIGN LOANS AND CREDITS OF U.S. GOVERNMENT AGENCIES (excluding World War I Debts) (In $ Millions)

	September 30, 1978
I. EXTRAORDINARY POLITICAL ARREARAGES	
1. Authorities on Taiwan	$107.6 1/
2. Cuba	76.0
3. Vietnam and Cambodia	24.3
4. Unresolved Korean War Logistical Support	199.7
TOTAL POLITICAL	407.6
(percent of overall total)	(67%)
II. MAJOR ARREARAGES - Public long-term	
1. Iran	36.1
2. Zaire	34.0 2/
TOTAL MAJOR ARREARAGES	70.1
(percent of overall total)	(11%)
III. OTHER MAJOR ARREARAGES	
A. Public	
1. Long-Term	34.9
2. Short-Term & Accounts Receivable, of which:	84.1
Foreign Military Sales, Logistical Support, M.A.A.G.	46.1
Lend-Lease	.6
Post Office	18.6
Other	18.8
B. Private	
1. Long-Term	13.0
2. Short-Term & Accounts Receivable	2.1
TOTAL OTHER ARREARAGES	134.1
(percent of overall total)	(22%)
IV. OVERALL TOTAL - Groups I, II, III	612.0

Note: Items may not add to totals due to rounding.

1/ Excludes, as of September 30, 1978, $49.8 million of principal and interest due from the authorities on Taiwan from assets left on the Asian continent, for which Export-Import Bank by agreement with that Government has deferred from pressing.

2/ Includes amounts rescheduled by bilateral rescheduling agreement with Zaire, T.I.A.S. No. 8731 (1976). Once implementing agreements have been concluded by the agencies concerned, these amounts will no longer be reported as being in arrears. Negotiations are being finalized to reschedule 1977 arrearages.

LONG-TERM DEBT OUTSTANDING TO THE U.S. GOVERNMENT BY PROGRAM, EXCLUDING WORLD WAR I DEBT

(in millions of dollars and equivalents)

	Dec. 31 1974	Dec. 31 1975	Dec. 31 1976	Dec. 31 1977	Sept. 30 1978
Foreign Assistance Act & related programs:					
Development Assistance	$12,635	$12,998	$13,435	$14,010	$14,872
Military Sales	1,627	2,270	3,462	4,779	5,531
Export-Import Bank Act	8,126	9,621	10,594	10,949	11,436
Agricultural Trade Development and Assistance Act	5,040	5,721	6,208	6,578	7,029
Other Programs 1/ 2/ (Lend-Lease/Surplus Property and other war accounts)	5,352 (1,649)	4,979 (1,520)	5,122 (1,421)	5,294 (1,368)	6,165 (1,336)
Total	$32,780	$35,589	$38,821	$41,610	$45,033

1/ Primarily 1946 British loan, lend-lease and other war accounts, and Commodity Credit Corp.
2/ Includes 1966 "Freeloc" agreement with France.

artment of the TREASURY NEWS
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FOR RELEASE AT 4:00 P.M. February 2, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,700 million, to be issued February 15, 1979. This offering will not provide new cash for the Treasury as the maturing bills are outstanding in the amount of $5,711 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $2,800 million, representing an additional amount of bills dated November 16, 1978, and to mature May 17, 1979 (CUSIP No. 912793 Y5 9), originally issued in the amount of $3,409 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $2,900 million to be dated February 15, 1979, and to mature August 16, 1979 (CUSIP No. 912793 2G 0).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing February 15, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,162 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, 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, Friday, February 9, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) 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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders 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 on all accepted tenders 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. 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. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action 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 weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt on February 15, 1979, in cash or other immediately available funds or in Treasury bills maturing February 15, 1979. Cash adjustments will be made for difference between the par value of the 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 these bills 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 these bills (other than life insurance companies) must include in his or her 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 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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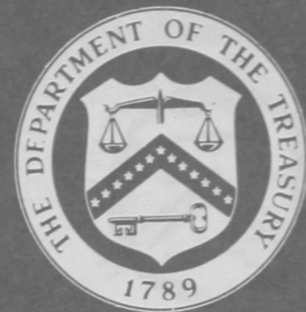

FOR IMMEDIATE RELEASE
February 2, 1979

Contact: Alvin M. Hattal
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TREASURY ANNOUNCES PRELIMINARY
COUNTERVAILING DUTY ACTION ON
AMOXICILLIN TRIHYDRATE FROM SPAIN

The Treasury Department today announced its preliminary determination that the Government of Spain is subsidizing exports of amoxicillin trihydrate to the United States. A final decision in this case must be made by July 27, 1979.

This investigation was begun after a petition was received July 27, 1978, on behalf of Biocraft Laboratories, Elmwood Park, New Jersey.

The Treasury found a subsidy paid in the form of an overrebate upon exportation of the Spanish indirect tax, the "Desgravacion Fiscal." The overrebate consists of three elements: (1) taxes on services and inputs not physically incorporated in the final product, (2) a credit for a tax on transactions between manufacturers and wholesalers which, in fact, is not levied on export sales, and (3) a number of Spain's "parafiscal" taxes included in the computation of the rebate, which are charges assessed for services provided and which are not levied on an ad valorem basis on the product. The Department's countervailing duty policy regarding this sort of tax system was set out in a Federal Register notice of January 17, 1979 (43 FR 3478).

The Countervailing Duty Law requires the Treasury to assess an additional customs duty equal to the net amount of a subsidy paid on imported merchandise.

Notice of this action appears in the Federal Register of February 2, 1979.

Imports of amoxicillin trihydrate from Spain during 1977 were valued at $1.2 million.

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FOR RELEASE AT NOON, PST
Friday, February 2, 1979

REMARKS BY THE HONORABLE
W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
LOS ANGELES WORLD AFFAIRS COUNCIL
FEBRUARY 2, 1979

I have been looking forward to addressing the World Affairs Council for some time. My originally scheduled appearance before you late last October, had to be cancelled because we were putting the finishing touches on the November package of measures designed to reverse the wayward course of the dollar. That last minute cancellation was for a good cause. The dollar has strengthened since November 1. Order has been restored to the foreign exchange markets. And most importantly, I can now talk about something other than the dollar!

So, today, I would like to deal with a broader subject -- international trade. Specifically: what is our present situation, what problems do we face, and what we can do to overcome them?

Trade is more important to the U.S. economy than most Americans realize. And it is becoming increasingly more important. In 1970 trade -- our exports plus our imports -- accounted for 8-1/2 percent of our Gross National Product. In 1978 it accounted for 15 percent. We know what the economic benefits of trade are. We depend on imports for essential raw materials; for a wide range of choice in consumer goods; for needed domestic competition and a spur to more efficient production; and as a source of jobs in import-dependent industries. And we depend on export markets as a means of selling a growing share of our national production; for jobs; and -- as we are finally beginning to realize -- to pay for our imports.

In political terms, trade is the source and substance of the relations between nations. It has been the source of war, and the lubricant of peace. When heads of state gather, as they did in Bonn last year and will again in Tokyo this summer, the talk is of trade. When nations form new links, the most concrete manifestation of that linkage is trade. The visit of China's Vice-Premier Deng Xiaoping is a case in point.

So we know that trade is important to us for economic and political reasons. Yet we also know that all is not well for United States' trade. We are importing far in excess of what we are exporting. We are not realizing our potential in world markets.

In 1977 and 1978 we ran record trade deficits of $31 billion and $34 billion respectively. The outlook for 1979 is for improvement: our trade deficit will move closer to $27 billion. But though some significant improvement is clearly in sight, the basic problem remains. We can and must do more to reduce our trade imbalance. We cannot continue to run deficits of these magnitudes and expect to maintain confidence in the dollar, or combat inflation, or enjoy continued solid growth of our own economy.

Let me quickly review the reasons for the improvement we expect this year.

Part of our trade deficit is cyclical in nature -- it reflects differences between rates of growth in the major industrial nations. And it reflects the high cost of oil imports and reduced price competitiveness due to exchange rate changes in 1975-1976. Recently we have seen a distinct turn-around in these underlying trends. American goods have become more price competitive; a cheaper dollar has assisted the saleability of our products. Our growth rate has slackened: in 1977 the U.S. economy grew at a 5-1/2 percent pace; in 1979 we project a 2-1/4 percent rate. And growth differentials between nations have begun to change. While our lower growing economy pulls in less foreign exports, faster growing economies abroad are buying more American goods.

The benefits of these underlying improvements began to show up in last year's trade flows. For example, U.S. trade performance in manufactured goods improved considerably between the first and last quarters of 1978. And slower growth at home, combined with our new domestic energy program, should help retard the growth of U.S. oil imports, even though higher oil prices will add to our import bill this year.

To summarize: We will see a substantially reduced trade and current account deficit in 1979. But further fundamental improvement will still be needed. The underlying problem of poor trade performance remains.

WHAT CAN'T WE DO?

What can we do? There are, I believe, five major options.

- -- First, we could entertain suggestions made by some irresponsible observers that we seek to drive down the value of the dollar on the assumption that this would improve the competitiveness of our goods;
- -- Second, we might reduce domestic economic growth in order to lower aggregate demand for imports;
- -- Third, we could act to constrain imports by imposing economy-wide import restraints;
- -- Fourth, we could focus on the other side of the equation and actively seek to increase U.S. exports; and

-- Fifth, to facilitate acceptance of our exports and free trade everywhere, we could work to eliminate other countries' barriers to trade and unfair competitive practices.

Let me deal with these "options" one-by-one.

The first is, quite simply, out of the question. We will indeed reap some benefit from the depreciation of the dollar that took place last year. But that depreciation came as a natural consequence of our then growing trade imbalance and rates of inflation. The dollar is clearly not overvalued now. It does not follow that further declines in the dollar would be good for trade. Besides, competitive devaluations do not work. It has never been the policy of the United States to seek them. And it never will be. From the standpoint of the domestic economy, we have found that the dollar's decline has serious inflationary consequences. It can threaten to undermine our anti-inflationary efforts by increasing the cost of imports and import-competitive goods by creating an atmosphere of instability and by damaging the climate for investment. Lastly, from the standpoint of today's market place, the tide is running the other way. Underlying economic forces, and our monetary and fiscal policies, point to a strong dollar.

The second option -- reducing domestic growth to lower demand for imports -- makes little sense. Imports now account for 8 percent of GNP. In its extreme form, the advocates of this let-the-tail-way-the-day approach are calling for a recession. Indeed, I have heard a few extremists argue that point, but they are not the ones that would be standing in line to collect unemployment checks.

The Administration is committed to maintaining a growing economy. To attempt to cure our trade problems with a recession would be foolish.

We will experience a lower rate of growth this year with the deliberate efforts of tighter monetary and fiscal policy. And this will slow down import growth. But the effort to slow growth is based on the need to combat inflation. I believe that this will be tolerated -- if not demanded -- by the American people, who increasingly have come to realize that inflation is a cancer.

The third option is also a non-starter. We cannot afford to restrict imports which are not coming into the country unfairly. Such measures would create massive distortions in the market. They would rob us of the benefits of an open world economy. They would likely generate similar import restraints by other nations in retaliation, which in turn would damage our exports. The final result would be an increase in prices for a wide range of products, throughout the world. We learned during the interwar period that beggar-thy-neighbor policies and trade restrictions provide no lasting benefits for anybody.

Maintaining open markets for foreign goods in a stable dollar environment is an important complement to our fight against inflation. U.S. import restraints already in place probably cost American consumers at least $20-$30 billion a year. The American public would be ill-served if we added to this already heavy burden.

This is not to deny that import restraints can selectively facilitate the orderly development of trading relations with other nations. It is important, for example, to protect our manufacturers against unfair dumping practices of other nations -- from their selling goods here at lower prices than they can be sold at home. And we must see to it that new imports do not rapidly and radically disrupt the production structure of the economy. For example, in normalizing relations with China we have opened up our market to a new supplier of textiles. Too rapid an infusion of Chinese textiles would clearly have disruptive consequences for our domestic industry. Thus we are presently negotiating an agreement with the Chinese for orderly growth in their exports to the U.S. of these materials.

My point is that there are cases to be made for selective restraints. The Administration will take action against unfair or disruptive practices by others in our home market. But we are best served by an open economy. Under today's conditions the wide-ranging restraint of all imports into the United States is not a practical policy.

WHAT WE CAN DO

The conclusion drawn is that the first three options do not obtain. We are left with the latter two, which are the right ones:

- We must focus our efforts on exports
- We must reduce the barriers that inhibit their acceptance abroad.

I would like to concentrate the remainder of my remarks on how to get on with this important job.

IMPROVING OUR EXPORT PERFORMANCE

The government and the business community must work as partners toward improving our competitiveness in world markets. Let me review what I consider to be the four key areas where work is needed.

- First, we must develop an "export mentality" throughout the business sector;
- Second, we must succeed in gaining a larger share of the important Japanese market;
- Third, we must overcome the low rate of growth of U.S. productivity of recent years;
- Fourth, we must take advantage of new markets as they become accessible in the LDC's and other developing countries like the Soviet Union and the People's Republic of China.

First let's look at our export mentality. The industries which are now engaged in exporting are primarily the "giants". Reginald Jones, the Chairman of General Electric, told me recently that his company alone contributes $2 billion net to our balance of trade. But

smaller firms have not been as active, in part due to the high initial costs of entering foreign markets, and in part because they have concentrated on production for the domestic economy. And too, the route to the top of the corporate ladder is rarely through the international side, even in the largest corporations. There is little incentive for executives to think exports.

It is natural that U.S. producers concentrate their sales effort on the U.S. market. Foreign producers do too. They find that the huge and dynamic U.S. market is a profitable place. So they make a special "export model" just to sell in the United States. But not many U.S. manufacturers will make a special model to sell in Japan -- or in Europe, or in Brazil and other developing nations. Consequently, we have often failed to take foreign market tastes, preferences, specifications and opportunities into account in the design and production of U.S. goods.

U.S. industry has also become accustomed to highly sophisticated distribution and sales systems. But in many foreign economies, exporters still face "mom and pop" stores and inefficient distribution systems that are designed for small volumes. Inventory management and distribution networks are far more complicated. Unusual effort must be put into studying and working these markets. Corporations that focus on short term earnings per share often find these start-up expenses to be onerous.

There may be a good bit more we can do, both through the public and private sector, to improve our export mentality. The government must learn to work for, rather than against, the interests of exporting businesses. The U.S.-Japan Trade Facilitation Committee, inaugurated in October 1977, exemplifies the kind of effort needed to improve information about what we have to sell, what foreigners want to buy, and to provide a forum for examining particular trade problems. But we still need export-minded firms to take advantage of these new efforts on the part of the government.

I can point to Japan as a case where American corporations could do more than they realize. The Government of Japan does inhibit imports in many ways quite inappropriate for their type of advanced economy. U.S. exports to Japan are still limited by residual import quotas on agricultural goods; by high tariffs on a range of manufactured goods; by deliberately protective tariffs in such important sectors as computer equipment, film, photographic equipment and some semiconductors; by lengthy approval procedures for imports of manufactured goods; by government procurement rules with a strong "buy-Japan" tilt; and by special import restraints for politically sensitive industries.

A number of these problems have been discussed within the Multilateral Trade Negotiations; and we hope to secure a substantial liberalization in some of these areas. But more liberalization is needed from the Japanese Government. The Carter Administration and the Congress are determined to continue working with the Government of Japan to assure that their market -- particularly for manufactured goods and the agricultural products with which the U.S. is especially competitive -- is as accessible to us as ours is to the Japanese.

But we must also acknowledge that American corporations have themselves been slow in realizing that Japanese import barriers have already begun to weaken. Japanese markets for many modern manufactures, for example, are largely open to foreign competition. The concept of "Japan Inc." is losing relevance as markets for basic and semi-processed materials are opened to import competition. Yet the U.S. share of most export markets in Japan has been shrinking for a number of years. Japan is an example of where a "can't do" mentality hurts us. Businessmen from other countries face the same barriers to marketing in Japan as we do. But they have increased their market shares at our expense. The U.S. share of consumer non-durable imports by Japan, for example, fell from 32 percent in 1968-70 to 13 percent in 1976-77; from 40 percent to 27 percent for consumer durables; and from 61 percent to 51 percent for capital equipment.

American exports to Japan will not improve simply because the Japanese remove trade barriers. In Japan, as elsewhere, competitors from the Pacific basin, Latin America and Western Europe will rush in as barriers come down. To out-perform this competition we will have to overcome our low rate of productivity growth.

U.S. output per manhour in the manufacturing industries increased only slightly more than 25 percent between 1970 and 1976, while Japanese productivity grew by more than 50 percent, and German, French and Italian productivity grew by more than 35 percent. Last year, American manufacturing productivity grew an abysmal 0.8 percent.

Many factors determine the rate of growth of labor productivity. One of the most important of these is the rate at which we expand our capital base. The stock of productive capital per worker increased every year in the post-war period up to 1974. Since then, the process of capital accumulation has come to a complete halt.

There are many reasons for this: declining real profit margins, uncertainties about energy costs and availabilities, excessive regulation. We have taken steps to remove these roadblocks.

Our anti-inflation program will help restore after-tax real profits. A stronger dollar will enhance the environment for portfolio investment. Our recently enacted tax program should also assist investment through a cut in the corporate rate, a reduction in capital gains taxation, and an improved investment tax credit. These initiatives should result in a net reduction of some $7 billion in taxes on income derived from capital investment. The energy legislation enacted by the last Congress will work to eliminate uncertainties about the supplies of energy, particularly natural gas.

It is remarkable how, with the enactment of one bill by Congress, a permanent geological scarcity can suddenly turn into a glut of natural gas -- at least temporarily. Perhaps we can find a formula for doing the same for crude oil.

Finally, investment should benefit from our efforts to get control of the unnecessary preempting of resources by regulatory authorities. The Carter Administration is the first Administration

ever to institute an internal program for a cost-benefit assessment of individual regulations. The costs are staggering. We intend to pare them down.

Still, more must be done to stimulate R&D and increased productivity. I would welcome any suggestions you might have as to how.

A fourth area where we need to make a special effort is in exploiting new markets. I needn't say much on this common sense subject. The developing countries obviously provide a great opportunity. And the Soviet and Chinese markets must not be neglected.

U.S. exports to the Soviet Union have quadrupled to $2.2 billion since we signed our first major trade agreement with them. But most of this total is agricultural goods. We only exported some $500 million in manufactured goods to the U.S.S.R. last year. This compares with manufactured exports of nearly $3 billion by Germany, $2 billion by Japan, $1-1/2 billion by France, and $1 billion by Italy. The opportunities for the U.S. are self-evident.

Obviously, the United States will not export goods to the U.S.S.R. which are of strategic consequence. However, in the non-strategic, non-defense related areas where the Germans and others have been doing a better job, the potential is considerable.

As for China, normalization offers a great deal. China's ambitious economic goals to spur modernization, and her recent liberalization of foreign trade and finance policies have marked an "opening to the West". We have gotten off to a late start in this game. Now we have the opportunity to begin making up lost ground.

We still have many obstacles to overcome. We have yet to put in place the basic arrangements needed for the conduct of a normal trading relationship between our two countries. There is no civil aviation agreement. There is no shipping agreement. We have no trade agreement with the Chinese. And in striving to put these arrangements in place we must overcome the obstacles posed by the need to settle the claims/assets issue, the absence of most favored nation status and the lack of official credit facilities.

The Chinese market is vast. Trade between the U.S. and China increased two-fold in 1978 to approximately $1 billion. Again, much of this is agricultural trade and much, much more can be done on the industrial side. The potential is there. But it will take time to materialize; the process will be a gradual one. The Chinese need to develop improved means of financing purchases. They need to put in place the facilities like housing and American consular offices that are needed to support American businessmen. And the facilitation of business applications by the Chinese bureaucracy will have to be further rationalized.

The Administration will be working hard in the coming weeks and months, together with the Chinese, to pave the way for American corporations to do business in China.

REDUCING BARRIERS ABROAD

To guarantee the acceptance of American goods everywhere, the Administration continues to negotiate with our trading partners to reduce tariffs and quotas on imports from the United States. This is done within a multilateral context in Geneva and bilaterally in the form of trade agreements with specific countries.

Increasingly a new form of barrier or interference is cropping up in our dealings with major competitors. This is the problem of government subsidies to aid exporting and domestic producing industries.

The roster of state-assisted industries reads like a "Who's Who" of current sectoral problems: steel, data-processing, aircraft, autos, shipbuilding, textiles, shoes, machine tools, electronic components. The aids have spread rapidly from country to country in a vain attempt to gain a competitive edge in both domestic and foreign markets, and at considerable cost to national treasuries.

Government action to aid these industries is not surprising. Their importance to national economies generates very strong political and economic pressures for government protection and assistance. Such assistance is usually introduced in the name of laudable domestic economic goals: increased employment, greater industrial efficiency, and longer term research and development efforts. However, in many cases it has become a means of avoiding structural adjustment and represents one of the most troublesome areas in our trade relations.

Efforts now being made in the Multilateral Trade Negotiations being finalized in Geneva offer an opportunity to help govern the international use of these subsidies. These efforts have borne fruit. The Brazilians, for example, have just announced that they will be phasing out all of their export subsidies over the next four years. Progress in these areas should help assure that trade is more fair, as well as more open, in the future.

CONCLUSION

In summary, the Carter Administration is working hard to improve the nation's export performance and reduce its trade imbalance. But like most other tasks in our mixed economy, we as a government cannot go it alone. We need your support for the initiatives that we have taken to pave the way for improved export performance by our corporations. We need your suggestions for further initiatives. And we need a new determination by corporations of all sizes to identify and exploit the export opportunities that are already abundant.

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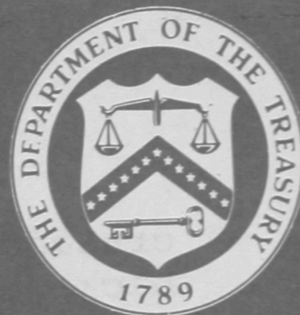

FOR IMMEDIATE RELEASE
Friday, February 2, 1979

REMARKS OF THE HONORABLE
W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
AT THE OLD MINT
SAN FRANCISCO, CALIFORNIA
FRIDAY, FEBRUARY 2, 1979

I'm pleased to join with members of this community today as we mint the first Susan B. Anthony dollar coin here in San Francisco.

I know many of you worked very hard for passage of the legislation which enables us to be here today. This is a significant event -- not only are we introducing a coin which will be cost efficient to business and to government, but we are breaking an old government tradition -- and believe me that is no easy feat.

In the past, most coins had a liberty figure obverse design. But for this new coin Congress has chosen to honor a real woman, one of the first suffragists, Susan B. Anthony, instead of a mythical figure. Isn't it refreshing to know that we have finally decided to move away from myths and toward reality. It's time we all realized that women have as much a right to be depicted on our coins as men, Indians and even buffalos and eagles, time to realize that women be given the credit they deserve, and time to recognize them for their accomplishments. They should not merely be the obverse side of coins, of men or of anything, but they must be fully recognized as persons in their own right. As Victor Hugo said, "There is one thing stronger than arms, and that is an idea when its time has come." Ms. Anthony -- this is your time. We honor Susan B. Anthony on this dollar coin for all she has done for the struggle for human rights, and especially for her striving to help women gain the right to vote. It is particularly appropriate to do so at a time when our nation has become so conscious of helping others with their quest for human rights.

It is time the United States portrayed a woman on a coin, for we are one of the few countries which until now had no real female likeness represented on any of our coinage. Perhaps that is why the dollar was in some trouble. When Susan used to

crusade from town to town to advocate women's rights, she was backed by her father's money. Now we need Susan to back our money.

When President Carter signed the new coin act, he said, "This new coin will be a constant reminder of the continuing struggle for the equality of all Americans." It reminds me too of our constant struggle to stabilize the dollar. Susan Anthony, I sure hope you can help us now.

I'm not going to recite a litany of accomplishments and praises for the person we honor in this way. From what I understand about her, she wouldn't have wanted that. As she once said of President Roosevelt, "When will men do something besides extend congratulations? I would rather have President Roosevelt say a word to Congress in favor of amending the constitution to give women the suffrage than to praise me endlessly."

In response to her wishes, I will not congratulate her, but will ask all those here today to join in a conscious effort to continue the fight for human rights -- the fight she began so many years ago. If you all remember her motto, "Failure is Impossible," it will help provide us with the inspiration to proceed.

As for the new dollar coin itself, we anticipate much success. With your cooperation, that of retail firms, commercial banks, and the general public, it will soon become an effective medium of exchange. It is smaller and lighter than the present Eisenhower coin and it will replace demand for one dollar bills. The Government will save 60 percent on the cost of minting dollar coins -- this will amount to a savings of roughly $4.5 million dollars a year -- a fact of no small significance to an Administration that is striving to balance its budget. With increased production generated by successful circulation, the savings will multiply.

The Anthony coin will be advantageous to private industry -- including major retailers, banks, and transit companies -- because of faster, easier handling of coins compared to notes. Also the automated merchandising industry will be able to offer a far wider range of products to consumers. Time will be saved at cash registers. It will be faster to count money both manually and automatically. Even a 20% displacement of notes by coins would permit Treasury to defer for at least the foreseeable future, a costly expansion program at the Bureau of Engraving and Printing.

In addition, the new design has an inner border -- providing a means for tactile recognition by the visually handicapped. The sandwich laminate of cupro-nickel makes the coin difficult to counterfeit or slug.

Susan Anthony was once described as having a "finely organized constitution and a good degree of compactness and power."

I wish to describe our new dollar coin in the same way.

As to the concern that the new coin is inflationary -- this simply is not the case. The increased use of higher value coins in this and other developed countries is the consequence rather than the cause of the general inflationary trend.

As the purchasing power of the lowest denomination rate declines, the highest value coin becomes a far more necessary component of a nation's coinage and currency system.

My feeling is that this coin could be one of the most valuable coins one can possess -- for it underlies a dual issue -- this nation's tremendous concern with human rights and with inflation. The intention is that we will succeed in extending the former and halting the latter.

In closing, let me relate a piece of advice Susan Anthony received from an uncle. He said to her, "If you want to be a real success, you have to make the world notice you." She replied, "I'll make them stare." Little did she know that the whole world would one day be staring at her likeness on a one dollar coin.

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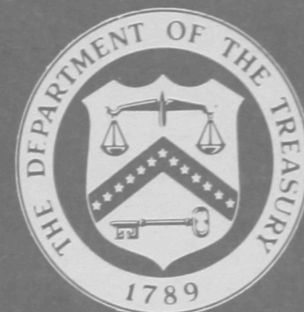

FOR RELEASE ON DELIVERY
EXPECTED AT 11:00 A.M.
FEBRUARY 5, 1979

TESTIMONY OF STEPHEN J. FRIEDMAN
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON ANTI-TRUST AND MONOPOLY
OF THE
SENATE COMMITTEE ON THE JUDICIARY

Mr. Chairman and Members of this distinguished Subcommittee:

I am pleased to present the views of the Treasury Department on the important issues being considered by this Subcommittee. I am accompanied by Mr. Michael Melton of the Treasury's Office of Tax Policy and Mr. William Posner of the Internal Revenue Service. They will be available to answer questions concerning the application of the Federal tax laws.

The role of pension funds as investors is central to the equity markets and to the broader questions of corporate legitimacy now being widely considered. They present a textbook case of the evolution of legal and financial institutions. Pension funds have grown in importance as sources of employee savings and of equity capital. Their nature has changed with their size and with evolving theories of portfolio management so that they now severely strain traditional concepts. The old ideas no longer fit.

B-1384

The issues under consideration by this Subcommittee illustrate that evolution. In a pension trust the location of ownership -- that is, legal title -- is clear. But as the differing obligations and interests of fiduciaries, employees, retirees and the employer become better understood, along with the changes worked by ERISA, the fact of technical ownership becomes less relevant. The allocation of the attributes of ownership -- voting rights and the power to determine investment policies -- do not inevitably follow legal title.

Similarly, the rule of prudence has been with us for a considerable time. But we have poured that old wine into a a new bottle -- and changed its character. It is now part of the new complex of ERISA rules designed for employee benefit plans, not common law rules developed for traditional testamentary trusts with life estate and remainderman.

ERISA was the first major step in giving contemporary form to the legal institutions that contain and shape the development of employee benefit plans. This Subcommittee is embarked on the next stage of that process. I would like to suggest some principles that might guide the Subcommittee's work in this effort.

- We should distinguish between the effect of the prudent investor rule and broader considerations of public policy. A proposed course of conduct involving social investment could be consistent with the prudent investor rule but raise other policy concerns for Congress.

- It is important to maintain the principle of diversity in our financial markets. The interaction of large numbers of decision-makers is important to the efficiency of the markets in allocating capital and imposing economic discipline on the management of firms.

- We must look skeptically at suggestions that tend to politicize the investment process. This nation has a long history of distrust of the use of concentrated private economic power to secure private social and political ends.

With that brief background, let me turn to the issues now before this Subcommittee.

Voting Power

The legal status of passing through the voting power of securities held by pension trusts to the ultimate participants and beneficiaries has not been fully clarified. Most observers believe there is substantial latitude for arrangements to share voting power. Nevertheless, that practice is not widely followed. It is, in our view, too early for the Congress to mandate a particular form of participation.

We are not aware of any substantial abuse of the voting power held by professional pension fund managers. Rather, we are concerned that this voting power is not actively exercised, or is generally exercised more or less automatically in favor of management. Professional pension fund managers have made it abundantly clear that they do not regard the exercise of voting rights as an important part of their job. Their investment judgments are based on total return and their remedy for dissatisfaction with a management or its policies is to sell the company's securities.

At the same time that the proportion of equities held by pension funds is increasing, the importance of the shareholder voting process is receiving increasing attention as a way of giving reality to the ownership rights of shareholders. Thus, the SEC has amended its proxy rules to enhance the effectiveness of shareholder participation. Open channels are important to corporate legitimacy and as an antidote to pressure for government regulation of corporations. Greater individual participation should enhance the accountability of management and increase the confidence in the financial system of individual investors and pension fund participants. But this approach rests on the assumption that individuals can participate.

The more active exercise of voting power raises its own problems. We can readily foresee the result if corporate shares were actively voted by large financial institutions to implement the social views of their management. There would be concern about the concentration of voting power. We would share that concern, and think that the more active use of voting power should be accompanied by its diffusion.

That prospect raises myriad questions about pass-through arrangements. Let me list a few.

- If the pass-through of voting rights is mandatory, do we risk freezing the structure of this important innovation before its true character is understood?

- What is gained by a pass-through of voting rights to the employer in those plans that are not jointly administered? There is, assuredly, a greater diffusion of voting power, but that voting power will not necessarily be exercised more actively. And there is no reason to think that in single-employer plans the employees will be consulted more than is the case now.

- Should voting rights be exercised by a joint labor-employer committee even in cases where the plan is not jointly administered?

- Is it important to have a neutral chairman? Should the employer participate at all?

- In the case of jointly administered plans, should it be assumed that the union officials appointed to serve as trustees are necessarily the correct persons to represent employees in voting shares, or should a different group be elected by the employees?

- What disclosure obligations should be imposed upon the employee representatives to insure that the employees know how their rights are being exercised?

- Is it important that retirees be represented in the voting process?

- How about insurance companies that manage pension assets under annuity and other arrangements? Should the right to vote the underlying securities remain in the insurance company because the fund employees have, in effect, invested only in the securities of the insurance company -- _i.e._, the annuity?

Our review of these and other issues suggests that we do not now have an adequate fund of experience to determine what problems are created by differing institutional arrangements and that it is far too early to codify any particular form of employee participation. It is important to maximize flexibility and experimentation and to permit an assessment by the Congress of the costs and benefits of these arrangements.

Investment Decisions

I would like to turn now to the far more thorny question of restricting or directing investment decisions for reasons unrelated to return on investment. It is important to recognize that this is a relatively new development and that its ramifications are only beginning to be understood. Ian Lanoff of the Department of Labor will consider the application of the prudent investor rule to the question of the extent to which fiduciaries are free to consider what are called social factors in choosing an investment. Suffice it to say for my purposes that the prudent investor rule leaves to the persons managing the portfolio a good deal of discretion provided that the investment chosen carries a risk and a return that is appropriate for the portfolio in light of the relevant factors.

Moreover, there are other ways in which the preferences of employers and participants can be expressed. For example, they can make their views known on an informal basis without restricting the portfolio manager's freedom of action. If portfolio managers find even the expression of views unduly restricting, they are free to decline to manage the funds.

During these hearings, the Congress has been asked to approve conduct that may raise questions under current law. In our view, it would be premature to act now. And we believe there is even more reason in this area than in the case of voting rights for the Congress to proceed slowly.

While the exercise of voting rights is an important aspect of shareholder democracy, it is not an essential element of the investment process. Hence, plans can experiment with relatively little impact on existing arrangements for money management or for resolving conflicts among the parties

to pension arrangements. That freedom is not present when we look at investment rather than voting. In addition, the direction of investment for social reasons may raise the spectre of greater use of concentrated economic power for noneconomic purposes and may well interfere with the markets' allocative function. Let me elaborate.

Institutional Arrangements for Money Management

A direction not to invest in a particular company, or even in a particular industry, may not so limit a portfolio manager's choices that any legal question arises under the prudent investor rule. Nevertheless, the portfolio manager may feel inhibited from attaining the investment objectives that have been set for him. He may choose to reject any significant limits on his freedom of choice.

The freedom to do so should be left with the managing institution. If the plan sponsors prefer a more compliant manager, they are free to choose another. On the other hand, there is nothing in the current state of the law that prohibits such directions; it is simply that those giving the directions have fiduciary responsibility for their actions. The resulting diversity of approach is healthy, since it provides us with a wealth of experience. In particular, it permits the markets to demonstrate whether there is truly a trade-off between investment performance and the acceptance of directions related to social ends.

The Resolution of Competing Interests

The institutional arrangements for directing social investments must be adequate to accommodate the conflicting interest involved. In a defined benefit plan, the employer has an incentive to press for a high yield, since it reduces the required contributions. Indeed, one of the functions of the prudent investor rule is to restrain the thrust toward assuming more risk than is appropriate.

Social investments could raise a different problem if the Congress were to permit them to take the form of a lower yield (or a higher risk in relation to the yield) than would otherwise be chosen. What of the employer, whose funding obligations would be increased by lower yielding investments?

If the percentage of the portfolio placed in such investments is sharply limited by the prudent investor rule, then the impact on the employer will be small, and the issue is not a serious one. But if the amount is significant to the portfolio, surely the employer should consent before its liability is increased.

There are also other interests that must be accommodated. As other witnesses in these hearings have suggested, the interest of retirees must also be taken into account.

These are quite complex questions, and I suggest we are seeing only the tip of the iceberg. We need considerably more experience to see whether any serious problems are involved.

Concentration of Economic Power

We are concerned about the use of large aggregations of wealth to achieve political or social ends. If a large bank trustee or the chief financial officer of a company with a large, internally managed pension fund were to employ its economic power to support a general anti-union animus, or projects that support patterns of segregated housing or education, we would be disturbed even if no violations of the law were involved. The money invested is held in stewardship, and should not be used to further the personal views of the steward -- and certainly not at the cost of the beneficiaries. There has been a historic effort in this country to divorce political decisions from economic power.

Our concern is no less because the power may be exercised by a union or other employee group instead of management. For example, some have suggested a prohibition on investments in nonunion companies. The labor laws strive to strike a balance between the rights of employees and employers, and the capital markets were not weighed in the balance when the basic compromises were struck.

The balancing of risk and return in the investment process imposes political neutrality on the investment process. When we step off neutral ground, we must tred warily. This is not to say that individuals, trustees and portfolio managers must be blind to other concerns when funds are invested. But we are dealing here with matters of degree. When the social motivation comes to occupy a larger sector of investment decision-making, it raises entirely new kinds of problems.

Allocation of Capital

Social investments may sometimes distort the markets' basic function of allocating capital. That is seen most clearly in suggestions that pension funds be reinvested in the areas from which they are generated or be invested in certain sectors of the economy. There are, of course, examples of credit allocation of this kind in our economy. Often, they do not work well. They represent subsidies, which in our view are often better generated and controlled by the political process. And they would divert the major institutional source of equity capital from its basic role.

The strength of our markets has historically lain in the free interaction of a large number of participants. This process enables society to make decisions concerning the risk-return evaluations among alternative uses. The process is dynamic, and both reflects and affects the views of investors and users of capital. Decisions concerning the most efficient use of resources are best made by individual investors acting with full information. Impediments to that process, including structural constraints which result in the preference of one investment over another, are in general to be avoided.

* * *

Mr. Chairman, that concludes my formal testimony. I would be pleased to answer any questions the Subcommittee may have.

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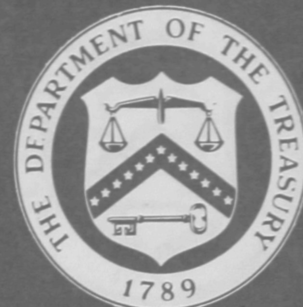

FOR IMMEDIATE RELEASE February 5, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,807 million of 13-week Treasury bills and for $3,000 million of 26-week Treasury bills, both series to be issued on February 8, 1979, 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 10, 1979			26-week bills maturing August 9, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.687	9.150%	9.50%	95.304	9.289%	9.88%
Low	97.677	9.190%	9.54%	95.291	9.315%	9.91%
Average	97.678	9.186%	9.53%	95.295	9.307%	9.90%

Tenders at the low price for the 13-week bills were allotted 53%.
Tenders at the low price for the 26-week bills were allotted 87%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 150,825,000	$ 120,825,000	$ 36,830,000	$ 21,830,000
New York	5,291,795,000	2,368,395,000	5,362,695,000	2,719,695,000
Philadelphia	20,145,000	17,530,000	10,110,000	9,530,000
Cleveland	29,415,000	24,415,000	104,430,000	71,530,000
Richmond	51,015,000	21,015,000	25,055,000	15,055,000
Atlanta	33,505,000	31,100,000	82,940,000	27,390,000
Chicago	339,595,000	118,260,000	214,400,000	18,385,000
St. Louis	39,955,000	16,680,000	32,300,000	12,300,000
Minneapolis	18,225,000	6,225,000	15,960,000	7,960,000
Kansas City	20,195,000	18,490,000	22,010,000	21,985,000
Dallas	13,175,000	12,175,000	10,315,000	10,315,000
San Francisco	217,320,000	37,235,000	265,035,000	50,035,000
Treasury	14,880,000	14,880,000	14,050,000	14,050,000
TOTALS	$6,240,045,000	$2,807,225,000a/	$6,196,130,000	$3,000,060,000b/

a/Includes $372,345,000 noncompetitive tenders from the public.
b/Includes $241,915,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

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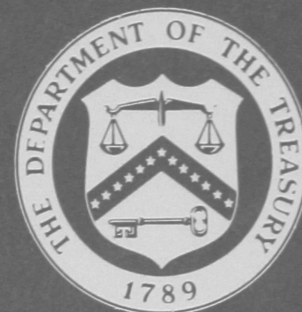

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M.
February 6, 1979

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Committee:

I am here today to advise you of the need for an increase in the public debt limit. I am also requesting an increase in the authority to issue long-term securities in the market and an increase in the statutory interest rate ceiling on savings bonds. After discussing these specific debt management requirements, I would like to comment on our recent issues of securities denominated in foreign currencies. Then, I will discuss the need to strengthen the process by which Congress establishes the debt limit.

Debt Limit

Turning first to the debt limit, the present temporary debt limit of $798 billion will expire at the end of March, and the debt limit will then revert to the permanent ceiling of $400 billion. Based on our current estimates, however, the $798 billion ceiling will be exceeded sooner -- around March 9. Legislation by that date will be necessary, therefore, to permit the Treasury to borrow to refund maturing securities and to pay the Government's other legal obligations. This assessment on timing is virtually identical to that which I presented to you in testimony last July. Thus, Congress was made aware at that time that the $798 billion limit probably would not be enough to carry us through March 31.

Let me explain why legislative action is needed by early March. The debt subject to limit actually would exceed the $798 billion sooner -- by the end of this month -- unless we reduce our normal $15 billion cash balance assumption.

As a practical matter, we believe that we can get through this month without any serious debt limit problems, since the assumed $15 billion cash balance is more than we need for this period.

Our cash balance requirements fluctuate substantially, because of the seasonal flows of tax receipts and outlays, but we think that we can safely run the cash balance down to approximately $7 billion at the end of this month. At the end of February last year our cash balance was $7.4 billion. On this basis, the debt subject to limit could be kept below $798 billion until approximately March 9.

In the circumstances, I strongly urge that Congressional action on the debt limit be completed as soon as possible.

Over the longer term, our current estimates of the amounts of debt subject to limit at the end of each month through the fiscal years 1979 and 1980 are shown in the attached table. The table indicates that the debt subject to limit will increase to $833 billion at the end of September 1979, and to $893 billion on September 30, 1980, assuming a $15 billion cash balance on those dates. These estimates are consistent with the budget estimates which the President submitted to Congress on January 22. The usual $3 billion margin for contingencies would raise these amounts to $836 billion in September 1979, and $896 billion in September 1980. Thus, the present debt limit of $798 billion should be increased by $38 billion to meet our financing requirements through the remainder of fiscal 1979 and by an additional $60 billion to meet the requirements in fiscal 1980.

The amount of the debt subject to limit approved by Congress in the September 1978 Budget Resolution is also $836 billion for the fiscal year ending September 30, 1979. Yet, since the Budget Resolution does not have the force of law, it will be necessary for Congress to enact a new debt limit bill before the Treasury can borrow the funds needed to finance the programs approved by Congress last September.

Bond Authority

I would like to turn now to our need for an increase in the Treasury's authority to issue long-term securities in the market without regard to the 4-1/4 percent ceiling.

Under this Administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. This policy has caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965, the average maturity of the privately-held marketable debt was 5 years, 9 months. By January 1976, it had declined to 2 years, 5 months, because huge amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing large needs for cash of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years, 4 months currently.

Debt extension has been accomplished primarily through continued and enlarged offerings of long-term bonds in our mid-quarterly refundings as well as routine offerings of 15-year bonds. These longer-term security offerings have contributed to a more balanced maturity structure of the debt in order to facilitate efficient debt management in the future. Also, these offerings have complemented the Administration's program to restrain inflation. By meeting some of the Government's new cash requirements in the bond market rather than the bill market, we have avoided adding to the liquidity of the economy at a time when excessive liquidity is being transmitted into increasing prices.

Congress has increased the Treasury's authority to issue long-term securities without regard to the 4-1/4 percent ceiling a number of times, and in the debt limit act of August 3, 1978, it was increased from $27 billion to the current level of $32 billion. To meet our requirements in the remainder of the fiscal year 1979, the limit should be increased to $40 billion; and to meet our requirements in the fiscal year 1980, the limit should be increased to $55 billion.

The Treasury to date has used about $30 billion of the $32 billion authority, which leaves the amount of unused authority at about $2 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $23 billion increase in the bond authority

would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1980. We are currently issuing long-term securities at an annualized rate of approximately $15 billion.

Savings Bonds

In recent years, Treasury has recommended frequently that Congress repeal the ceiling on the rate of interest that the Treasury may pay on U.S. Savings Bonds. The current 6 percent statutory ceiling was enacted by Congress in 1970. Prior to 1970 the ceiling had been increased many times as market rates of interest rose and it became clear that an increase in the savings bond interest rate was necessary to provide investors in savings bonds with a fair rate of return.

Mr. Chairman, we do not feel that an increase in the interest rate on savings bonds is necessary today. Yet, we are concerned that the present requirement for legislation to cover each increase in the rate does not provide sufficient flexibility to adjust the rate in response to changing market conditions. The delays encountered in the legislative process could result in inequities to savings bond purchasers and holders if interest rates rise on competing forms of savings.

The Treasury relies on the savings bond program as an important and relatively stable source of long-term funds. On that basis, we are concerned that participants in the payroll savings plans and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with comparable forms of savings. In this regard, market interest rates increased substantially in 1978 and are currently close to the historic highs reached in the 1973-74 period when the savings bond interest rate was increased from 5-1/2 percent to 6 percent. Moreover, there was a significant increase in savings bond redemptions last year. Savings bond sales exceeded redemptions by $748 million in 1975, $793 million in 1976, and $840 million in 1977. However, in 1978, as market rates of interest increased, redemptions exceeded sales by $236 million. The resulting cash loss to the Treasury, which has been steadily increasing in the past few months, must be made up by increasing the amounts the Treasury borrows in the market, and the Treasury is currently paying significantly higher interest rates on its market borrowings. If this situation continues, it may be essential to increase

the savings bond interest rate in order to avoid further substantial cash drains to the Treasury and permanent damage to the savings bond program.

Any increase in the savings bond interest rate by the Treasury would continue to be subject to the provision in existing law which requires approval of the President. Also, the Treasury would, of course, give very careful consideration to the effect of any increase in the savings bond interest rate on the flow of savings to banks and thrift institutions.

While I continue to believe that the savings bond interest ceiling should be removed, I recognize that it may not be possible to gain prompt approval by Congress of a proposal to eliminate the ceiling. Thus, I am requesting that the ceiling be increased at this time from 6 percent to 6-1/2 percent. This one-half of one percent increase should be enough to provide us with the flexibility we need at this time.

Foreign Currency Issues

Let me turn briefly to the issuance of Treasury securities denominated in foreign currencies.

As you know, Mr. Chairman, on November 1, 1978, the Treasury announced its intention to issue up to $10 billion in securities denominated in foreign currencies. The purpose of these borrowings is to acquire foreign currencies which the United States can use in its exchange market operations.

The securities are issued pursuant to Section 16 of the Second Liberty Bond Act (31 U.S.C. 766), which provides specific authority for the Secretary of the Treasury to issue securities denominated in foreign currencies. These are public debt securities, and, as such, are direct obligations of the United States. The amount of their issuance is subject to the public debt limit.

On December 15, 1978, the Treasury issued the first of these obligations, in the form of three- and four-year notes denominated in Deutsche marks, in an aggregate amount of approximately DM 3.0 billion ($1.6 billion dollar equivalent). Just recently, on January 26, 1979, the Treasury issued two and one-half and four-year notes denominated in Swiss francs totaling SF 2.0 billion ($1.2 billion dollar equivalent).

The interest rates which the United States is paying on these obligations are substantially below current domestic interest rates. The notes were offered through the central banks of Germany and Switzerland, acting as agent on behalf of the United States. There were no commissions associated with these offerings, and this is unprecedented in both countries for a public offering of a foreign borrower.

There were special features associated with our German and Swiss offerings which were intended to restrict final investors. In each offering, the notes were placed only with residents of the country in whose currency they are payable. Also, only very limited transferability was permitted among such residents. Further, the German Bundesbank and the Swiss National Bank maintain a register of beneficial owners, and transfers are only effected after each central bank checks to insure that the transferee is a resident of the respective country. These limitations will help minimize the extent to which dollar holdings might be converted into foreign currencies for the purchase of the securities, which would tend to counter the intended purpose of the offerings.

The decision to sell these foreign-denominated securities, as part of the November 1 program, was made to help deal with the severe and persistent disorders in foreign exchange markets, and excessive declines in the dollar, which were undermining our efforts to control inflation and damaging the climate for investment and growth in the United States.

Debt Limit Process

Mr. Chairman, I would now like to comment on the process by which the public debt limit is established.

It is well recognized that the present statutory debt limit is not an effective way for Congress to control the debt. In fact, the present debt limit process may actually divert public attention from the real issue -- control over the Federal budget. The increase in the debt each year is simply the result of earlier decisions by Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional budget procedures and provided a more effective means of controlling

the debt. That Act requires Congressional concurrent resolutions on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

Moreover, the statutory limitation on the public debt occasionally has interfered with the efficient financing of the Federal Government and has actually resulted in increased costs to the taxpayer. For example, when the temporary debt limit expired on September 30, 1977, and new legislation was not enacted on the new debt limit until October 4, and again when the limit lapsed from July 31, 1978 to August 3, 1978, Treasury was required in the interim periods to suspend the sale of savings bonds and other public debt securities. The suspension of savings bonds sales, in particular, resulted in considerable public confusion, additional costs to the Government, and a loss of public confidence in the management of the government's finances.

Accordingly, I believe that the public debt would be more effectively controlled and more efficiently managed by tying the debt limit to the new Congressional budget process. I hope that we can work together to devise an acceptable way to do this.

Attachment

PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1979
Based on: Budget Receipts of $456 Billion,
Budget Outlays of $493 Billion,
Unified Budget Deficit of $37 Billion,
Off-Budget Outlays of $12 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1978	-Actual-		
September 30	22.4	773	
October 31	15.5	778	
November 30	12.9	784	
December 29	16.3	790	
1979			
January 31	15.1	792	
	-Estimated-		
February 28	15	804	807
March 30	15	809	812
April 30	15	807	810
May 31	15	822	825
June 29	15	810	813
July 31	15	819	822
August 31	15	826	829
September 28	15	833	836

PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1980
Based on: Budget Receipts of $503 Billion,
Budget Outlays of $532 Billion,
Unified Budget Deficit of $29 Billion,
Off-Budget Outlays of $12 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1979		-Estimated-	
September 28	15	833	836
October 31	15	843	846
November 30	15	856	859
December 31	15	857	860
1980			
January 31	15	858	861
February 29	15	874	877
March 31	15	881	884
April 30	15	872	875
May 31	15	889	892
June 30	15	878	881
July 31	15	887	890
August 29	15	897	900
September 30	15	893	896

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FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
February 6, 1979

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

I am here today to advise you of the need for an increase in the public debt limit. I am also requesting an increase in the authority to issue long-term securities in the market and an increase in the statutory interest rate ceiling on savings bonds. After discussing these specific debt management requirements, I would like to comment on our recent issues of securities denominated in foreign currencies. Then, I will discuss the need to strengthen the process by which Congress establishes the debt limit.

Debt Limit

Turning first to the debt limit, the present temporary debt limit of $798 billion will expire at the end of March, and the debt limit will then revert to the permanent ceiling of $400 billion. Based on our current estimates, however, the $798 billion ceiling will be exceeded sooner -- around March 9. Legislation by that date will be necessary, therefore, to permit the Treasury to borrow to refund maturing securities and to pay the Government's other legal obligations. This assessment on timing is virtually identical to that which I presented to you in testimony last July. Thus, Congress was made aware at that time that the $798 billion limit probably would not be enough to carry us through March 31.

B-1387

Let me explain why legislative action is needed by early March. The debt subject to limit actually would exceed the $798 billion sooner -- by the end of this month -- unless we reduce our normal $15 billion cash balance assumption.

As a practical matter, we believe that we can get through this month without any serious debt limit problems, since the assumed $15 billion cash balance is more than we need for this period.

Our cash balance requirements fluctuate substantially, because of the seasonal flows of tax receipts and outlays, but we think that we can safely run the cash balance down to approximately $7 billion at the end of this month. At the end of February last year our cash balance was $7.4 billion. On this basis, the debt subject to limit could be kept below $798 billion until approximately March 9.

In the circumstances, I strongly urge that Congressional action on the debt limit be completed as soon as possible.

Over the longer term, our current estimates of the amounts of debt subject to limit at the end of each month through the fiscal years 1979 and 1980 are shown in the attached table. The table indicates that the debt subject to limit will increase to $833 billion at the end of September 1979, and to $893 billion on September 30, 1980, assuming a $15 billion cash balance on those dates. These estimates are consistent with the budget estimates which the President submitted to Congress on January 22. The usual $3 billion margin for contingencies would raise these amounts to $836 billion in September 1979, and $896 billion in September 1980. Thus, the present debt limit of $798 billion should be increased by $38 billion to meet our financing requirements through the remainder of fiscal 1979 and by an additional $60 billion to meet the requirements in fiscal 1980.

The amount of the debt subject to limit approved by Congress in the September 1978 Budget Resolution is also $836 billion for the fiscal year ending September 30, 1979. Yet, since the Budget Resolution does not have the force of law, it will be necessary for Congress to enact a new debt limit bill before the Treasury can borrow the funds needed to finance the programs approved by Congress last September.

Bond Authority

I would like to turn now to our need for an increase in the Treasury's authority to issue long-term securities in the market without regard to the 4-1/4 percent ceiling.

Under this Administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. This policy has caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965, the average maturity of the privately-held marketable debt was 5 years, 9 months. By January 1976, it had declined to 2 years, 5 months, because huge amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing large needs for cash of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years, 4 months currently.

Debt extension has been accomplished primarily through continued and enlarged offerings of long-term bonds in our mid-quarterly refundings as well as routine offerings of 15-year bonds. These longer-term security offerings have contributed to a more balanced maturity structure of the debt in order to facilitate efficient debt management in the future. Also, these offerings have complemented the Administration's program to restrain inflation. By meeting some of the Government's new cash requirements in the bond market rather than the bill market, we have avoided adding to the liquidity of the economy at a time when excessive liquidity is being transmitted into increasing prices.

Congress has increased the Treasury's authority to issue long-term securities without regard to the 4-1/4 percent ceiling a number of times, and in the debt limit act of August 3, 1978, it was increased from $27 billion to the current level of $32 billion. To meet our requirements in the remainder of the fiscal year 1979, the limit should be increased to $40 billion; and to meet our requirements in the fiscal year 1980, the limit should be increased to $55 billion.

The Treasury to date has used about $30 billion of the $32 billion authority, which leaves the amount of unused authority at about $2 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $23 billion increase in the bond authority would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1980. We are currently issuing long-term securities at an annualized rate of approximately $15 billion.

Savings Bonds

In recent years, Treasury has recommended frequently that Congress repeal the ceiling on the rate of interest that the Treasury may pay on U.S. Savings Bonds. The current 6 percent statutory ceiling was enacted by Congress in 1970. Prior to 1970 the ceiling had been increased many times as market rates of interest rose and it became clear that an increase in the savings bond interest rate was necessary to provide investors in savings bonds with a fair rate of return.

Mr. Chairman, we do not feel that an increase in the interest rate on savings bonds is necessary today. Yet, we are concerned that the present requirement for legislation to cover each increase in the rate does not provide sufficient flexibility to adjust the rate in response to changing market conditions. The delays encountered in the legislative process could result in inequities to savings bond purchasers and holders if interest rates rise on competing forms of savings.

The Treasury relies on the savings bond program as an important and relatively stable source of long-term funds. On that basis, we are concerned that participants in the payroll savings plans and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with comparable forms of savings. In this regard, market interest rates increased substantially in 1978 and are currently close to the historic highs reached in the 1973-74 period when the savings bond interest rate was increased from 5-1/2 percent to 6 percent. Moreover, there was a significant increase in savings bond redemptions last year. Savings bond sales exceeded redemptions by $748 million in 1975, $793 million in 1976, and $840 million in 1977. However, in 1978, as market rates of interest increased, redemptions exceeded sales by $236 million. The resulting cash loss to the Treasury, which has been steadily increasing in the past few

months, must be made up by increasing the amounts the Treasury borrows in the market, and the Treasury is currently paying significantly higher interest rates on its market borrowings. If this situation continues, it may be essential to increase the savings bond interest rate in order to avoid further substantial cash drains to the Treasury and permanent damage to the savings bond program.

Any increase in the savings bond interest rate by the Treasury would continue to be subject to the provision in existing law which requires approval of the President. Also, the Treasury would, of course, give very careful consideration to the effect of any increase in the savings bond interest rate on the flow of savings to banks and thrift institutions.

While I continue to believe that the savings bond interest ceiling should be removed, I recognize that it may not be possible to gain prompt approval by Congress of a proposal to eliminate the ceiling. Thus, I am requesting that the ceiling be increased at this time from 6 percent to 6-1/2 percent. This one-half of one percent increase should be enough to provide us with the flexibility we need at this time.

Foreign Currency Issues

Let me turn briefly to the issuance of Treasury securities denominated in foreign currencies.

As you know, Mr. Chairman, on November 1, 1978, the Treasury announced its intention to issue up to $10 billion in securities denominated in foreign currencies. The purpose of these borrowings is to acquire foreign currencies which the United States can use in its exchange market operations.

The securities are issued pursuant to Section 16 of the Second Liberty Bond Act (31 U.S.C. 766), which provides specific authority for the Secretary of the Treasury to issue securities denominated in foreign currencies. These are public debt securities, and, as such, are direct obligations of the United States. The amount of their issuance is subject to the public debt limit.

On December 15, 1978, the Treasury issued the first of these obligations, in the form of three- and four-year notes denominated in Deutsche marks, in an aggregate amount of approximately DM 3.0 billion ($1.6 billion dollar equivalent). Just recently, on January 26, 1979, the Treasury issued two and one-half and four-year notes denominated in Swiss francs totaling SF 2.0 billion ($1.2 billion dollar equivalent). The interest rates which the United States is paying on these obligations are substantially below current domestic interest rates. The notes were offered through the central banks of Germany and Switzerland, acting as agent on behalf of the United States. There were no commissions associated with these offerings, and this is unprecedented in both countries for a public offering of a foreign borrower.

There were special features associated with our German and Swiss offerings which were intended to restrict final investors. In each offering, the notes were placed only with residents of the country in whose currency they are payable. Also, only very limited transferability was permitted among such residents. Further, the German Bundesbank and the Swiss National Bank maintain a register of beneficial owners, and transfers are only effected after each central bank checks to insure that the transferee is a resident of the respective country. These limitations will help minimize the extent to which dollar holdings might be converted into foreign currencies for the purchase of the securities, which would tend to counter the intended purpose of the offerings.

The decision to sell these foreign-denominated securities, as part of the November 1 program, was made to help deal with the severe and persistent disorders in foreign exchange markets, and excessive declines in the dollar, which were undermining our efforts to control inflation and damaging the climate for investment and growth in the United States.

Debt Limit Process

Mr. Chairman, I would now like to comment on the process by which the public debt limit is established.

It is well recognized that the present statutory debt limit is not an effective way for Congress to control the debt. In fact, the present debt limit process may actually divert public attention from the real issue -- control over the Federal budget. The increase in the debt each year is

simply the result of earlier decisions by Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional budget procedures and provided a more effective means of controlling the debt. That Act requires Congressional concurrent resolutions on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

Moreover, the statutory limitation on the public debt occasionally has interfered with the efficient financing of the Federal Government and has actually resulted in increased costs to the taxpayer. For example, when the temporary debt limit expired on September 30, 1977, and new legislation was not enacted on the new debt limit until October 4, and again when the limit lapsed from July 31, 1978 to August 3, 1978, Treasury was required in the interim periods to suspend the sale of savings bonds and other public debt securities. The suspension of savings bonds sales, in particular, resulted in considerable public confusion, additional costs to the Government, and a loss of public confidence in the management of the government's finances.

Accordingly, I believe that the public debt would be more effectively controlled and more efficiently managed by tying the debt limit to the new Congressional budget process. I hope that we can work together to devise an acceptable way to do this.

Attachment

PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1979
Based on: Budget Receipts of $456 Billion,
Budget Outlays of $493 Billion,
Unified Budget Deficit of $37 Billion,
Off-Budget Outlays of $12 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1978	-Actual-		
September 30	22.4	773	
October 31	15.5	778	
November 30	12.9	784	
December 29	16.3	790	
1979			
January 31	15.1	792	
	-Estimated-		
February 28	15	804	807
March 30	15	809	812
April 30	15	807	810
May 31	15	822	825
June 29	15	810	813
July 31	15	819	822
August 31	15	826	829
September 28	15	833	836

PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1980
Based on: Budget Receipts of $503 Billion,
Budget Outlays of $532 Billion,
Unified Budget Deficit of $29 Billion,
Off-Budget Outlays of $12 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1979	-Estimated-		
September 28	15	833	836
October 31	15	843	846
November 30	15	856	859
December 31	15	857	860
1980			
January 31	15	858	861
February 29	15	874	877
March 31	15	881	884
April 30	15	872	875
May 31	15	889	892
June 30	15	878	881
July 31	15	887	890
August 29	15	897	900
September 30	15	893	896

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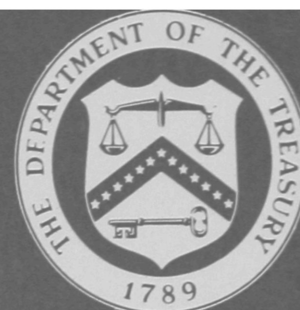

For Release Upon Delivery
Expected at 11:30 a.m.
February 6, 1979

STATEMENT OF
DONALD C. LUBICK, ASSISTANT SECRETARY
OF THE TREASURY (TAX POLICY)
BEFORE THE
SENATE HUMAN RESOURCES COMMITTEE
FEBRUARY 6, 1979

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to appear before you today to discuss S. 209 concerning the private pension system.

S. 209 represents a revision of S. 3017 introduced in the last Congress as to which this Department expressed its views in hearings on August 15, 1978.

I would like to comment here today on the major provisions of S. 209 which affect the Internal Revenue Code and matters within the jurisdiction of the Treasury Department--administration of ERISA, tax deductions for employee contributions and tax credits for new plans, and joint and survivor annuities.

We plan to submit shortly a brief analysis and the position of the Department on the less far reaching changes also proposed by S. 209.

B-1388

Dual Jurisdiction

As you know, the President's Reorganization Plan Number 4 went into effect on December 31, 1978. This plan to divide rulemaking jurisdiction between the Departments of Treasury and Labor is described in the testimony of the Department of Labor. We are confident that this plan will reduce substantially the difficulties caused by previously overlapping rulemaking authority. The plan is designed to be evaluated by the end of January, 1980. Based on that evaluation, the Administration may submit legislative proposals for a long term administrative structure for ERISA. This interim plan does not prevent adopting a single agency approach in the future, but we believe it would be premature to enact a single agency structure at this time as S. 209 suggests.

We have not supported the single agency concept to date in part because we are reluctant to thrust a new administrative system on the pension industry before there has been a more in-depth analysis of the problems it raises. There are two major areas of concern to the Treasury Department. First, a single agency will not eliminate the need to coordinate with the Internal Revenue Service; the agencies will have to begin again to learn to cooperate on a different basis. Second, reducing the role of the IRS in determining eligibility for tax benefits may impair equity in the tax system.

The first concern I stated arises because the private pension system is now based on tax incentives and penalties. Like other single agency proposals, S. 209 uses these incentives and penalties, recognizing that the potential loss of tax benefits may be a more effective deterrent than the threat of injunctive relief or other action by an agency other than the IRS. Under S. 209, the new agency would certify the tax qualification or disqualification of a plan to the Service. Such qualification affects issues left to the Service, including taxation of participants on distribution, the employer's deduction, and possibly the assessment and collection of excise taxes under sections 4971 through 4975 of the Internal Revenue Code.

A few isolated precedents exist for certification by another agency to the IRS for tax purposes. In general, however, these cases involve a single factual determination made at a single point in time. 1/ In contrast, in the area of tax-qualified pension plans, tax qualification must be

based on the plan in operation. The result must be continued certification of operational facts as affecting tax liability; initial qualification does not suffice.

This procedure requires coordination of tax audits with the other agency or, if all functions are transferred, presumably an entirely separate audit of pension issues with IRS auditors instructed not to raise such matters. If the IRS is required to await determinations by another agency, its ability to conclude audits of the employer and all plan participants would be impaired. If an employer's plan fails to be certified for a tax year in which other tax issues are also present, and the total tax liability of the employer must be litigated, substantial coordination of the issues raised would be required between the IRS and the new agency. In other words, new types of dual jurisdiction would exist.

Under S. 209, the Internal Revenue Service would not be entitled to apply the excise tax that is now used to deter the underfunding of pension plans. However, this valuable enforcement tool would be available to the new agency only if transferred to it by the President; in the absence of his action, neither agency would be entitled to use the excise tax deterrent. Further, such a transfer would add to the duties of the new agency the assessment, litigation in the United States Tax Court and collection of such taxes. These duties are in all other cases reserved to the Internal Revenue Service. If the bill were modified to allow the Internal Revenue Service to impose the tax, another area of dual jurisdiction would be established.

Furthermore, the more "certification" one places in a single agency, the more likely it is that tax equity may be compromised. S. 209 would transfer the Code's qualification standards (including nondiscrimination and limits on benefits for the highly compensated) to the new agency. Discriminatory treatment and excessive contributions may seriously compromise tax equity and yet may have little to do with retirement security, as evidenced by the fact that they are not presently a concern of the Department of Labor. Therefore, continued IRS authority over these issues seems appropriate.

To reiterate, the dual jurisdiction reorganization plan developed within the Administration has important and immediate benefits; it does not develop new problems, nor does it weaken enforcement of employee rights. Nonetheless, we recognize the importance of, and encourage, this dialogue to fully examine the issues before the pension community may again be subjected to a new form of administration.

Deductible Employee Contributions to Qualfied Plans

Under section 203 of S. 209, an employee who is an active participant in any one of a number of types of tax-favored plans may make a deductible contribution to the plan. The deductible contribution is limited to the lesser of 10 percent of compensation for the taxable year or $1,000. However, deductions are not permitted for contributions by "highly paid" employees unless an antidiscrimination test is met.

As we have indicated in prior testimony, 2/ we are concerned with the issues addressed by section 203 of the bill, and we believe that consideration of the possibility of deductions for employee contributions to all types of retirement plans is appropriate, provided that there is assurance of nondiscriminatory coverage and benefits, and that the amounts deferred are not excessive.

We believe that Congress has made substantial progress in addressing many of the related issues in this area by enacting in the Revenue Act of 1978 the provisions relating to cafeteria plans, cash and deferred profit sharing plans and certain unfunded deferred compensation arrangements for government employees. However, the issues involved in the context of deductible employee contributions to IRAs and retirement plans are different in terms of the impact on qualified plans, the complexity inherent in providing equitable solutions and the amount of revenue potentially involved. Section 203 of S. 209 reflcts a thoughtful and well reasoned approach to this complicated problem. However, there are a number of bills which have been or will be proposed which also address these issues. Accordingly, we do not wish to take a definitive position at this time regarding the provisions of Section 203. We would like to continue to work with you and your staff as well as other members of Congress who have introduced legislative proposals in this area and we hope to reach a mutually satisfactory conclusion.

Credits for New Plans

S. 209 provides a tax credit in the case of new qualified plans. The credit begins at 5 percent in the first plan year and ends with 1 percent in the fifth year, and is applied to the employer's total plan contribution, up to the deductible limit. The new plan credit is available to employers which are "small businesses". A small business for these purposes must have a monthly average of fewer than one

hundred employees, and net profits in the first credit year not exceeding $50,000. No credit is allowed in a year during which an employer terminates a qualified plan. The credit is not allowed for contributions to an ESOP. It is, however, available for contributions to Keogh plans.

According to a study appearing in the November, 1975 Social Security Bulletin, the portion of the nongovernmental labor force covered by a retirement plan was 46.2 percent in 1975. Although that percentage was an increase from 42.1 percent in 1970, we have no reason to believe that much more than one-half of the nation's labor force is now covered by private pension plans. Employees working for small employers tend to be among those who are least likely to be covered by a private pension plan. The purpose of the bill is the encouragement of such small employers in the establishment of plans for their employees.

It is probably true that a major improvement in coverage by private plans will not be accomplished within the present framework of incentives. However, there is not to our knowledge sufficient information about the gap in coverage so as to be able to target tax benefits narrowly enough to provide a substantial increase in coverage without an unacceptably large revenue cost. Because of the number of plans already in existence which may be replaced with a "new plan", or which will be established by employers in any event, there will be a substantial tax cost under the bill even if no employer changes his or her mind as a result of the offered credit. Although the bill provides for denial of the credit in a year in which a prior plan was terminated, there is no protection against termination in one year and the reestablishment of the same program as a "new plan" in the following year.

We are pleased that in this bill you have narrowed the class of employers eligible for the credit. As you know, in our testimony last year on S. 3017 we recommended considering such a refinement, as well as considering the employees' average pay or the amount of the assets of the employer as a means of making the provision more effective. However, without clearer information as to the gap in coverage and the portions of that gap which might be affected by new incentives, we cannot evaluate the appropriateness of the change. Nor can we determine the need for some alternative limitation. It is possible that employers with net income under $50,000 are the least likely to be affected by the proposed credit.

We understand that during 1979 both the Office of Policy Planning and Research of the Department of Labor and the Presidential Pension Task Force will be studying the make-up of the employees not covered by any plan. We share your desire to expand the coverage of our private pension system. However, with the information these studies will provide, we believe that a more direct and efficient system of encouragements may be designed.

Master and Prototype Plans

In addition to the preceding measures designed to encourage more savings for retirement, S. 209 would establish mechanisms for special master plans.

The bill proposes that the master plan sponsor--the bank, insurance company, or other investment manager--be considered the plan administrator and named fiduciary for purposes of Title I of ERISA. We concur in the Labor Department's support of this part of the proposal.

As you know, the Internal Revenue Service is an enthusiastic supporter of, and has developed several different types of, master and prototype plans. The major difference between S. 209 and existing IRS procedures for master plans for corporate employers--from the perspective of the tax law--is that under the bill employers are given the protection normally afforded only after a determination letter is issued without the need to apply for such a letter. The IRS does not believe such a provision is workable unless a plan covers all employees and has full and immediate vesting. In the absence of this requirement, a determination of qualification cannot be made without examination of the employer's workforce.

The bill provides that, notwithstanding the general qualification of the master plan, the Internal Revenue Service may, upon audit, determine that the plan, in operation, does not satisfy the qualification requirements. This finding may not be retroactive unless there is also a finding that the failure was intentional or due to willful neglect. It is particularly difficult in the broad spectrum of situations facing the Internal Revenue Service with regard to plans and their qualified status to determine whether a particular failure is due to intentional or willful neglect. In many cases of small plans, records are unavailable and development of proof of the willfulness required by the bill would be extremely difficult. The effect of such difficulty would perhaps invite many plans to take advantage of the

situation believing that in all probability if they were caught they would merely be required to make a prospective change.

The Internal Revenue Service is presently studying its authority under section 7805(b) to selectively apply the effects of the retroactive disqualification of a plan. This may include the treatment of a plan as not qualified with respect to those persons most directly involved with the maintenance of the plan, coupled with the continued treatment of the plan as qualified, or at least the prospective only disqualification of the plan, with respect to those who are innocent employees simply caught in the middle. Such treatment has been applied with respect to a large multiemployer plan, and should in some circumstances be applicable in the case of a small plan.

Pending the further development of administrative relief, it is recommended that this provision not be enacted.

Joint and Survivor Annuity

The changes proposed in S. 209 to ERISA's joint and survivor annuity rules are highly technical. Yet they raise broad and significant policy issues that must be addressed before any changes are effected. Under both Title I of ERISA and section 401(a) of the Internal Revenue Code, special rules apply if a plan provides for the payment of benefits in the form of an annuity. 3/ Under those rules, the annuity benefits must be paid in the form of a qualifying joint and survivor annuity to the participant and his or her spouse unless the participant elects not to receive payment of the benefit in that form. These rules apply generally where the participant is entitled to receive benefit payments at or after reaching normal retirement age, or at a plan's early retirement age if it has one. The vesting rules of ERISA and the Code provide that employer-derived benefits may be forfeited upon the death of a participant (before or after retirement), except in the case of a survivor annuity payable under the joint and survivor annuity rules. Thus, the employer-derived benefits (other than the survivor annuity) can be forfeited even where a participant is fully vested and dies prior to the commencement of any benefit payments.

Section 127 of S. 209 would, in substance, change the vesting and joint and survivor annuity rules. First, the surviving spouse of a participant in a plan normally providing annuity benefits would be entitled to a survivor benefit where the participant has ten years of service and

dies before receiving the vested percentage of his or her employer-derived account balance or benefits.

Second, in plans not normally providing annuity benefits, any death benefit must be paid to the surviving spouse of the participant. No alternative is allowed.

The fundamental question is whether the vesting rule which allows forfeiture of employer-derived benefits upon death is a correct approach. The existence of any retirement plan implies that employees have received reduced immediate compensation in favor of the diversion of that compensation into the retirement plan. It can be argued that death should not result in the loss of the diverted compensation. On the other hand, at least in the context of a defined benefit plan, the diversion can be viewed as something like the purchase of an annuity. It is not illogical to accept the loss of future annuity payments on death, even if the annuitant dies before any payments have been made.

The second question follows only if, as a result of examination of the first question, the possibility of forfeiture upon death still remains. The question then is whether the death to be focused upon is solely that of the plan participant or the death of the survivor of the participant and his or her spouse. The current joint and survivor annuity rules, in effect, mean that both deaths must be taken into account in some situations. However, the current rules deal with the problem in a very confused and somewhat arbitrary manner.

The third question is whether, assuming there should be survivor benefit requirements of some sort, the participant should be allowed to elect against the payment of those benefits to the surviving spouse. For example, is it appropriate that the survivor benefits provided by the plan be paid to the participant's spouse if the spouse has sufficient other income, or is legally separated from a participant who is caring for other dependents?

We believe these issues should be dealt with specifically before this provision is adopted.

* * *

Mr. Chairman, that concludes my formal testimony. I would be pleased to answer any questions the Committee may have.

FOOTNOTES

1/ Examples of certification include, under prior law, the Department of Commerce certifying import injury for purposes of determining a taxpayer's entitlement to a special five-year loss carryback established under the Trade Expansion Act; the War Production Board certifying facilities as war emergency facilities in connection with the special amortization rules applicable to those facilities. Under present law, there is a similar certification procedure with respect to the amortization of pollution control facilities (I.R.C. Section 169); there is also special treatment for gain or loss under SEC orders (I.R.C. Section 1081) or FCC policy changes for radio stations (I.R.C. Section 1071).

2/ We testified on these matters before the Subcommittee on Oversight of the House Ways and Means Committee on February 16, 1978, before the Subcommittee on Private Pension Plans and Employee Fringe Benefits of the Finance Committee on March 15, 1978 and before a joint hearing of that Subcommittee and the Subcommittee on Labor of the Human Resources Committee on August 15, 1978.

3/ Under the Internal Revenue Service regulations interpreting this provision, the special rules apply only where the annuity is a life annuity. Thus, a plan's provision for the payment of an annuity for a term certain or for a term measured by the life expectancy of the recipient would not, in itself, result in application of the special rules.

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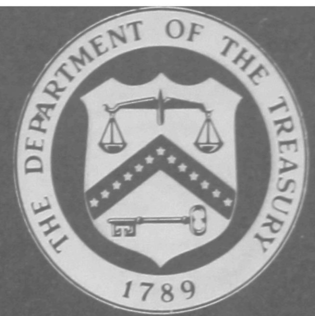

FOR IMMEDIATE RELEASE February 6, 1979

RESULTS OF AUCTION OF 8-YEAR NOTES

The Department of the Treasury has accepted $2,250 million of $5,210 million of tenders received from the public for the 8-year notes, Series B-1987, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	8.95% 1/
Highest yield	9.02%
Average yield	9.01%

The interest rate on the notes will be 9%. At the 9% rate, the above yields result in the following prices:

Low-yield price	100.281
High-yield price	99.888
Average-yield price	99.944

The $2,250 million of accepted tenders includes $366 million of noncompetitive tenders and $1,884 million of competitive tender from private investors, including 52% of the amount of notes bid for at the high yield.

In addition to the $2,250 million of tenders accepted in the auction process, $931 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, 1979.

1/ Excepting 4 tenders totaling $30,000

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WASHINGTON, D.C. 20220 TELEPHONE 566-2041

February, 1979

BIOGRAPHICAL NOTES
C. FRED BERGSTEN
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS

C. Fred Bergsten, 37, of Annandale, Va., has been Assistant Secretary of the Treasury for International Affairs from the outset of the Carter Administration. In that position, Dr. Bergsten has responsibility for the formulation and execution of a wide range of U.S. international economic and financial policies.

Dr. Bergsten graduated magna cum laude in 1961 from Central Methodist College in Missouri. He received M.A., M.A.L.D., and Ph.D. degrees from the Fletcher School of Law and Diplomacy, where he majored in international economics and international relations.

Dr. Bergsten was a Senior Fellow at the Brookings Institution from 1972 until joining the Carter/Mondale transition team, where he was in charge of all aspects of international economic policy, and then the Department of the Treasury. He was a Visiting Fellow at the Council on Foreign Relations during 1971-72 and 1967-69; Assistant for International Economic Affairs to Dr. Henry A. Kissinger at the National Security Council during 1969-1971; and an International Economist at the Department of State during 1963-1967.

Dr. Bergsten is the author or co-author of nine books and more than sixty articles on a wide range of international economic and monetary subjects. His The Dilemmas of the Dollar: The Economics and Politics of U.S. International Monetary Policy was published by the Council on Foreign Relations in early 1976. His latest volume, American Multinationals and American Interests, was published in mid-1978 by the Brookings Institution.

B-1390

Among his many honors, Dr. Bergsten is listed in *Who's Who in America* and was named one of Time Magazine's "200 Young American Leaders" in 1974. While at Brookings, he was a frequent witness before Congressional committees, testifying on such subjects as international monetary reform, overall U.S. foreign economic policy, commodities, trade, and international financial institutions.

Dr. Bergsten was born on April 23, 1941, in Brooklyn, New York. He is married to Virginia Wood Bergsten. They have a son, Mark David.

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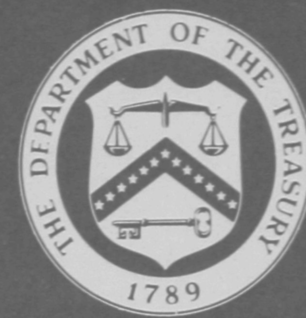

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
February 7, 1979

STATEMENT OF THE HONORABLE ROBERT H. MUNDHEIM
GENERAL COUNSEL OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TRADE
HOUSE WAYS & MEANS COMMITTEE

Mr. Chairman and Members of the Trade Subcommittee:

I am appearing this morning in support of the Administration's request that the Congress extend for a brief period the authority of the Secretary of the Treasury to waive temporarily the imposition of countervailing duties in selected cases.

The authority to waive countervailing duties was included in the Trade Act of 1974 so that during the 4-year period following its enactment, the Administration would be able to conduct talks with our trading partners in an atmosphere conducive to reaching agreement on an international regime to regulate the use of subsidies.

Governmental subsidies to domestic industries are an increasingly important phenomenon. As Congress recognizes, the best hope for preventing such subsidies from distorting trade patterns lies in international agreement. Ambassador Strauss has brought us close to successful conclusion of this difficult task.

Unfortunately, it was not possible to conclude the negotiations among a great many participants within the four years originally foreseen by the Trade Act. Thus, the bill before you has the very limited purpose of extending the waiver authority for the brief period during which the negotiations will be concluded. It does not commit you in any way to the

B-1391

substance of the MTN negotiations. You and your colleagues in the House and Senate will have a full opportunity to review what has been negotiated. In other words, the bill is intended simply to preserve the status quo for about 10 months. Doing so helps make possible the conclusion of agreements which will significantly benefit the United States.

When the waiver expired on January 2, orders that we had published in December suspended final liquidation of imports of the merchandise affected and required importers to deposit estimated duties, provide bonds to cover those duties, or post equivalent irrevocable letters of credit. Thus, if the waiver is not extended, the revenue will be fully protected. However, if, as contemplated in this bill, the waiver authority is extended, there will be no problem in making that extension retroactive.

There are presently 12 waivers in effect. Attached to my testimony is a chart showing all of the waivers granted under the law, the subsidy initially found and any amount remaining at this time. As you will see, in some cases, such as those involving Mexican steel or Brazilian handbags, there has been a complete elimination of the subsidy so that a revocation of the initial countervailing duty order was or is now appropriate. In the other cases, the bill would extend the waivers retroactively to January 3.

In addition, the bill would grant the Treasury authority to waive countervailing duties during the remaining pendency of the negotiations and Congressional consideration of the MTN package. In two cases decided before the expiration of our waiver authority -- concerning textiles from Brazil and fish from Canada -- we indicated that a waiver would be granted if such authority existed at the time that the ITC has completed its consideration of the case. There may also be one or two additional cases presently under consideration in which the subsidizing country may agree to significant reductions of its subsidy practices and is playing a significant role in the MTN negotiations so that a waiver might be appropriate. However, we anticipate that throughout the remaining life of the waiver authority, we would exercise the waiver authority pursuant to the same terms and conditions as this Administration has applied to the waivers granted -- subject, always, of course, to Congressional reporting and review. That course should assure us and our trading partners that the remaining months of the negotiations are not troubled by what may be regarded by some as a needlessly provocative or unfriendly act.

Finally, we will continue to review the waivers that are now outstanding. The current bill contemplates that we would revoke any waiver where changes in conditions under which it was granted warrant such action. We have taken such action in the past and would do so in appropriate circumstances in the future.

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COUNTERVAILING DUTY ACTIONS INVOLVING WAIVERS

Country	Date of Waiver	Publication Reference	Product	Subsidy on Date of Waiver	Subsidy on Feb. 1, 1979	Remarks
EEC	5/19/75	40 FR 21720	Dairy Products	Varied	Unchanged	
EEC	12/2/75	40 FR 55639	Canned Hams	16.5-20 Units of Account per 100 kg	25-30 Units of Account per 100 kg	Subsidy increase occurred 12/78
Mexico	1/7/76	41 FR 1273	Steel Plate	$.76/ton	Zero	Finding revoked
Austria	1/7/76	41 FR 1275	Cheese	Soft cheese, $.02-$.40/pound Hard cheese, $.20-$.33/pound	Zero	Finding soon to be revoked
Switzerland	1/8/76	41 FR 1468	Cheese	$.40-$.65/pound	$.60-$.96/pound	Increase due entirely to currency changes
Korea	1/9/76	41 FR 1587	Rubber Footwear	0.7% *ad valorem*	Unchanged	
Norway	5/27/76	41 FR 21767	Cheese	$.20-$.50/pound	Hard cheese-Zero Soft cheese-Unchanged	
Finland	6/18/76	41 FR 24703	Cheese	$.30-$1.70/pound	Zero on emmenthaler (except wheels) Others, $1.14-$1.66/lb.	Finding on emmenthaler (except wheels) soon to be revoked
Sweden	7/1/76	41 FR 27032	Cheese	$.40-$.50/pound	Unchanged	
Brazil	7/13/76	41 FR 28787	Leather Handbags	14% *ad valorem*	Zero	Finding soon to be revoked
Canada	4/12/77	42 FR 19327	Fish	17% *ad valorem*	1.17% *ad valorem*	
Denmark	1/5/78	43 FR 955	Butter Cookies	30% *ad valorem*	Unchanged	
Uruguay	1/30/78	43 FR 3904	Leather Handbags	17.4% *ad valorem*	14.4% *ad valorem*	Waiver revoked, liquidation suspended
Uruguay	1/30/78	43 FR 3904	Non-Rubber Footwear	23% *ad valorem*	16.0% *ad valorem*	Waiver revoked, liquidation suspended
Colombia	4/24/78	43 FR 18659	Leather Handbags	5.5% *ad valorem*	Zero	Finding soon to be revoked
Uruguay	6/1/78	43 FR 23709	Leather Apparel	12% *ad valorem*	13.3% *ad valorem*	Waiver revoked, liquidation suspended
Canada	6/16/78	43 FR 25995	Fish	17% *ad valorem*	1.17% *ad valorem*	
Brazil	11/16/78	43 FR 53425	Textiles and Apparel	37.2% *ad valorem*	17.0% *ad valorem*	Remaining subsidy to be eliminated by 1/1/80
Canada	12/29/78	44 FR 1728	Fish	1.17% *ad valorem*	Unchanged	

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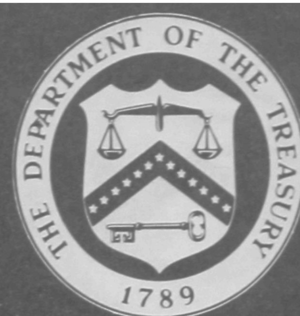

FOR IMMEDIATE RELEASE February 7, 1979

RESULTS OF AUCTION OF 29-3/4-YEAR TREASURY BONDS
AND SUMMARY RESULTS OF FEBRUARY FINANCING

The Department of the Treasury has accepted $2,001 million of the $4,304 million of tenders received from the public for the 29-3/4-year 8-3/4% Bonds of 2003-2008, auctioned today. The range of accepted competitive bids was as follows:

	Price	Approximate Yield To First Callable Date	Approximate Yield To Maturity
High -	97.40	9.01%	9.00%
Low -	96.90	9.06%	9.05%
Average -	97.05	9.05%	9.03%

The $2,001 million of accepted tenders includes $ 62 million of noncompetitive tenders and $1,939 million of competitive tenders from private investors, including 45% of the amount of bonds bid for at the low price.

In addition to the $2,001 million of tenders accepted in the auction process, $ 800 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, 1979.

SUMMARY RESULTS OF FEBRUARY FINANCING

Through the sale of the two issues offered in the February financing, the Treasury raised approximately $1.3 billion of new money and refunded $4.7 billion of securities maturing February 15, 1979. The following table summarizes the results:

	New Issues				
	9% Notes 2-15-87	8-3/4% Bonds 11-15-03-2008	Total	Maturing Securities Held	Net New Money Raised
Public...............	$2.3	$2.0	$4.3	$3.0	$1.3
Government Accounts and Federal Reserve Banks................	0.9	0.8	1.7	1.7	-
TOTAL........	$3.2	$2.8	$6.0	$4.7	$1.3

B-1392

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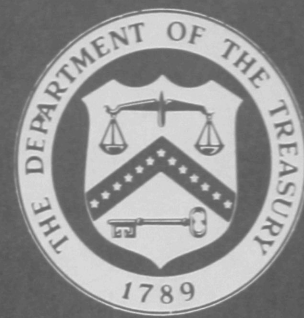

FOR RELEASE ON DELIVERY
EXPECTED AT 3:00 P.M.
February 7, 1979

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS

Mr. Chairman and Members of this distinguished Committee:

I am pleased to appear before you today to discuss the activities of the Treasury Department under the New York City Loan Guarantee Act. My testimony this afternoon will cover the following major areas:

-- A brief review of the fiscal crisis.

-- The City's financing plans -- how the four-year $4.5 billion long-term financing program has been implemented and the circumstances under which Treasury has issued guarantees.

-- The City's budget condition and budget outlook -- our assessment of the current fiscal year, and prospects for fiscal 1980 and the 1981-1982 period.

A Brief History

Mr. Chairman, I'd like to put this issue into some perspective by briefly reviewing the history of the New York City fiscal crisis. The City has made considerable progress since 1975, but that progress often is obscured by local political controversies.

B-1393

This crisis erupted in 1975 when the City lost access to conventional sources of borrowing and teetered on the edge of bankruptcy. It lost its ability to finance because it was incurring enormous budget deficits and had borrowed huge amounts of debt to finance them. Lenders had lost confidence in its ability to repay.

Those budget deficits reflected years of unsound budget practices and, in part, the severe national economic downturn of 1975. In addition, its books were unauditable and its financial reporting systems were not fuctioning.

The State of New York then undertook massive efforts to solve the City's fiscal problems. Among other things, it established the Municipal Assistance Corporation, the Financial Control Board and advanced $800 million to the City. It was not until Congress passed the New York City Seasonal Loan Act of 1975, however, that the City was actually saved from apparent bankruptcy.

In the intervening three and a half years, New York has made major financial strides, including:

-- Its operating deficit has been halved, and the recently presented 1980 budget plan will reduce that deficit to approximately one-third of the 1975 level.

-- The overhang of short-term debt has been funded. Indeed, its short-term borrowing needs have been cut from as high as $8 billion to the current year's $750 million.

-- The City has been independently audited for the first time and now is one of the few major U.S. municipalities to maintain a policy of independent audits.

-- It re-entered the public credit markets last month for the first time since 1975. The $125 million note sale was oversubscribed by investors, and these securities are now selling at a healthy premium.

-- A $4.5 billion long-term borrowing plan has been completed -- the largest in municipal financing history -- and is expected to cover the City's needs for the 1979-1982 period. A consortium of local commercial banks, savings banks, insurance

companies and the City employee pension funds has provided the core commitment to this plan.

Mr. Chairman, the City has met each of its budget goals and otherwise made considerable progress since Federal credit assistance was first provided in late 1975. We continue to believe that the outlook for achieving real budget balance and regaining full market access is good.

The Relationship of the Guarantee Act to the City's Financing Plans

Last June, before this Committee, Treasury argued for long-term Federal lending assistance for New York. We did not think that its solvency could be assured otherwise. This Committee and the overall Congress, of course, eventually agreed and passed the New York City Loan Guarantee Act of 1978.

Both Treasury and Congress favored, however, a series of budget and financing conditions, which should be satisfied before any Federal guarantees were issued. Let me turn now to a discussion of those financing conditions, and how they have been met. I will discuss the budget conditions later.

Our support for Federal guarantees last year was predicated on three key conditions:

-- That a financing plan be implemented to satisfy all of the City's short and long-term borrowing needs over the 1979-1982 period.

-- That the relevant local lending parties -- clearinghouse banks, City employee pension funds, and others -- would make large, new, unguaranteed long-term lending commitments to this plan.

-- Federal guarantees would be issued only to the extent that public and private lenders do not provide the necessary funds on an unguaranteed basis. Our hope was to avoid issuance of guarantees in the later years of the Financial Plan.

As indicated below, Congressional support for these conditions was made clear in Committee reports and throughout the legislative history. I would now like to discuss the Guarantee Act and how these conditions which underlie it were satisfied in assembling last fall the City's short- and long-term financing plans.

The Act itself, of course, authorized the Secretary of the Treasury to issue, over a four-year period, up to $1.65 billion of Federal guarantees of long-term City debt sold to the City and State employee pension funds. Before issuing any such guarantees, however, the Act requires the Secretary to "find" that a series of these conditions have been met. The crucial findings relative to financing include:

- -- That there exists a four-year financing plan which will satisfy the City's short- and long-term needs over the four-year period and return New York to full market access by 1982, assuring that the Financing Plan remains intact.
- -- That the City is eligible for guarantees because it does not have access to credit elsewhere, maximizing local participation in the financing.
- -- That there exist sufficient prospects for repayment of the guaranteed debt.

Once the Guarantee Act actually became law, negotiations began in earnest over the requisite short- and long-term financing plans. Let me briefly describe how these evolved.

First, the City, the Financial Control Board and Treasury agreed that $4.5 billion was the correct amount of long-term financing which should be sought over the four-year period. This was divided as follows:

Table I
1979-1982: Uses of Long-Term Funds

Purposes	Amount ($ in Millions)
True Capital	$2,300
Capitalized Expenses	900
Bonding of State Advance	400
MAC Capital Reserve Fund	300
MAC Refunding	600
	$4,500

Second, MAC, the City and Treasury sought the maximum, unguaranteed long-term lending commitments from the local parties. In addition, commitments on appropriate amounts of accompanying public sales of MAC and City bonds over the plan period were sought.

After three months of arduous negotiations, a long-term borrowing plan, with the following major characteristics, emerged:

-- A consortium of the Clearinghouse banks, local savings banks, insurance companies and the City employee pension funds agreed to purchase $1.8 billion of MAC Second Resolution bonds over the four-year period.

-- MAC agreed to sell publicly $1 billion of identical Second Resolution bonds in 1979 and 1980.

-- The City committed itself to use its best efforts to sell $300 million of its own bonds in 1981 and $650 million in 1982.

-- The City and State employee pension funds agreed to divide equally between them a total purchase of $750 million in federally guaranteed City bonds in 1979 and 1980. They also provided a stand-by commitment to purchase $950 million of guaranteed bonds in 1981 and 1982, if neither MAC nor the City can sell that amount in those years.

Table II below provides a detailed year-by-year breakdown of this long-term financing plan.

Table II

NEW YORK CITY

Long-Term Financing Plan FY 1979-1982

($ in Millions)

Source of Funds	1979	1980	1981	1982	Total
Private Placement of MAC Bonds	$ 401	$ 537	$ 537	$ 325	$1,800
Public Offering					
MAC Bonds	500	500			1,000
City Bonds	0	0	300 /1	650 /1	950
Federal Guaranteed City Bonds	500	250	0	0	750
Total	$1,401	$1,287	$ 837	$ 975	$4,500

/1 Backed up by stand-by guarantee authority up to $900 million if City and/or MAC bonds cannot be sold.

Treasury's judgment is that this plan is sound. In particular, we believe that the $1.8 billion in private lending commitments is firm. It is subject only to a limited number of conditions. While it would be preferable to avoid any such conditions, this is impossible because of the lenders' own fiduciary responsibilities to their respective stockholders and beneficiaries. The participating institutions are all affected to varying degrees by the prudent man rule, as well as by investment standards overseen by State and national regulatory agencies.

These private lending commitments, and the accompanying guarantee agreements, are embodied in a series of lengthy, technical documents, as follows:

-- The Agreement to Guarantee (among the United States, New York City, New York State, the Financial Control Board, and MAC) authorizes the Secretary of the Treasury to guarantee, pursuant to the Act, up to $1.65 billion of City bonds. It specifically requires that each of the conditions of eligibility under the Act be satisfied each time guarantees are issued.

-- The Guaranteed Bond Purchase Agreement (among the United States, New York City and New York State pension funds, and New York City) sets forth the schedule of purchases to be made by the pension funds of guaranteed bonds pursuant to the City's financing schedule.

-- The MAC Bond Purchase Agreement (among MAC, the participating commercial banks, savings banks, insurance companies and City pension funds) establishes the conditions whereby the financial institutions and pension funds commit to purchase $1.8 billion in MAC securities through City FY 1982.

-- The Loan Agreement (among the City, the commercial banks and City pension funds) which provided the City with a line of credit for its seasonal financing needs in FY 1979.

The City's Short-Term Borrowing Plan

The City also negotiated a $750 million 1979 line of credit, supplied in equal amounts by the clearinghouse banks and the City employee pension funds. This assured that its seasonal needs could be fully satisfied this year, even if the public note market was not available to the City.

Our judgment last fall was that the City did not need to negotiate seasonal lines of credit beyond 1979. New York's financial advisor, Dillon Read & Co., Inc., rendered its opinion that the City could obtain its full short-term needs from the public markets in 1980, 1981 and 1982, assuming that budget goals are met and that those markets are in reasonable condition. In addition, we expect the banks and City employee pension funds to renegotiate the lines of credit on an annual basis, as a backstop.

The recent successful note offering reinforces the likelihood that New York will be able to sell publicly the needed amounts of notes beyond 1979. Its first public sale in almost four years was completed a full year ahead of the schedule set forth by the City last year. I recognize the importance, Mr. Chairman, that you place on the City's return to the public credit markets in a rapid and effective a manner as possible. We share this objective. We think the initial acceptance of the City's securities by the credit markets, the rating services, underwriters and investors is a recognition of the progress the City is making.

Neither the Act nor Treasury's Agreement with the City require it to re-enter the public bond market before 1981. The recent note sale is encouraging and we hope that the City will undertake a bond offering before 1981, if it is possible. The City's re-entry into the bond market is more difficult than its entry into the note market.

Issuance of Guarantees

Our judgment is that this long-term financing plan, and the accompanying private lending commitment, satisfies the expectations of the Act concerning an overall plan for financing all of the City's need through 1982 and concerning maximum financing efforts by the relevant local parties.

I hope it is evident to this Committee that Treasury worked diligently to ensure that the financing agreements met those requirements.

On November 17, 1978, the Treasury, on behalf of the United States, issued $200 million of the $500 million in guarantees scheduled to be issued in the City's 1979 fiscal year. Treasury determined that all conditions of eligibility set forth in the Act were met at the time of this issuance, and your staff has reviewed the extensive documentation which Treasury developed in this regard.

The United States has already received its first payment from the City of the 1/2 percent guarantee fee provided under the Act. This fee amounted to approximately $123,000. This guarantee fee is payable quarterly under the terms of our Guarantee Agreement with the City.

The City and the State have requested that we issue an additional $150 million in guarantees on February 15, 1979. We will ensure that the financing, budget and other conditions in the Act are met by the City in this and all subsequent take-downs.

The New York City Budget Outlook

Let me turn now to a discussion of the City's budget outlook. This is the most important element in the New York City situation, Mr. Chairman. New York originally lost its ability to borrow because it was incurring high budget deficits. In turn, the key to fully regaining that ability is to achieve true budget balance. As you know, the City's financial plan is aimed at true balance by 1982.

New York has implemented a four-year financial planning process. In January of each year, it submits to the Financial Control Board a plan for closing the next fiscal year's budget gap. The plan also includes estimates of revenues and expenditures for the following four fiscal years, and projected City, State and Federal actions to close any gaps in those years. This four-year planning process itself represents a major step forward for the City.

Like any large financial entity, the City revises its financial plan frequently, to reflect changed trends in any major revenue or expenditure category. No particular plan should be viewed too rigidly, because such changes are normal and inevitable. Furthermore, each revision must be approved by the Financial Control Board before it can become effective.

As you know, Mr. Chairman, the City submitted its most recent Financial Plan on January 15. Treasury staff has carefully studied it together with our accounting consultants -- Arthur Andersen and Company -- and in consultation with other City monitoring groups. Our preliminary observations on these most recent budget plans are as follows:

1979 Budget

The City's budget for the 1979 fiscal year appears to be balanced in accordance with State law. The most recent 1979 budget modification was submitted January 15, 1979. It involved a net increase of $17 million in revenues matched by a corresponding increase in expenses.

The largest element of 1979 gross revenue loss is the transfer of the estimated $80 million of Westway revenue from fiscal year 1979 to fiscal 1980. It is worth noting that instead of using these Westway proceeds to reduce the projected 1980 gap, the City has chosen to use this non-recurring revenue as a reserve for 1981 wage settlements, a decision with which we fully concur. To compensate partially for the loss of Westway revenues, the unallocated portion of the general reserve has been reduced from $100 million to $70 million.

The 1980 Gap Closing Program

On January 15, the City also submitted its fiscal 1980 Program to Eliminate the Gap ("PEG"). This is a detailed program for eliminating the estimated $433 million potential 1980 budget deficit. It is not, however, an actual budget submission. The 1980 City budget will not be submitted to the City Council and Board of Estimate until May 1.

The table on the following page summarizes the 1980 PEG program and certain aspects of the budget outlook for the 1980-1983 period.

As I indicated, the 1980 budget deficit is estimated at $433 million -- virtually identical to the amount projected by the City last November. To put this estimate in perspective, it is useful to remember that the City's total 1980 revenues are estimated at $12.5 billion. The projected gap, therefore, represents approximately 3.5 percent of projected revenues.

Table III

Revised Four-Year Financial Plan ($mm)

	1980	1981	1982	1983
Estimated Gap (a)	($433)	($889)	($1,172)	($1,224)
1980 City Actions				
"Level I Program":				
Attrition:				
Uniformed Services	14.3	15.8	15.8	15.8
Health and Welfare	16.4	17.6	17.6	17.6
Other Mayoral Agencies	9.3	10.0	10.0	10.0
Board of Education	83.3	89.5	89.5	89.5
Non-Mayoral Agencies	17.7	19.1	19.1	19.1
Sub Total:	141	152	152	152
Other Actions:				
Reduced Procurement (b)	23	23	23	23
Reduced Reserve on Disallowances (b)	25	25	25	25
Increased Fees (b)	9	9	9	9
Future Program Reductions and Tax Increases	--	79	99	119
Proposed Special Reserve (b)	(57)	--	--	--
Net Level I	141	288	308	328
Adjusted Gap After Level I	(292)	(601)	(864)	(896)
Projected State Aid Increases	192			
Projected Federal Aid Increases	100			
"Level II Contingency Program"				
Further Attrition in Above Categories	52	65	65	65
Remaining Gap After City Level I and Level II Actions	($240)	($536)	($799)	($831)
Elimination of Special Reserve	57(b)	--	--	--
Needed Increases in State and/or Federal Aid	183	18	--	--
Recurring State and/or Federal Aid	--	183	201	201
Projected City Actions for Future Years to Eliminate Remaining Gap	--	$335	$598	$630

(a) Does not make provision for increased labor costs in 1981/1982.
(b) The City has proposed that a special reserve for contingencies of $57 million generated by other action Level I savings be established in addition to the $142 million general reserve already in the 1980 budget.

Mayor Koch is proposing to close the $433 million gap through: (1) $141 million in "Level I" City deficit reduction actions -- after giving effect to funding a proposed $57 million special contingency reserve --; (2) $192 million of increased State aid; and (3) $100 million of increased Federal aid. He has also set forth a "Level II" contingent plan involving $52 million of further deficit reduction actions at the City level. His position is that Level II will be implemented if there are shortfalls in anticipated State and/or Federal aid.

Let me now turn to a detailed discussion of the City's 1980 budget Plan.

City Deficit Reduction Actions

Level I is divided into two parts. The first is an attrition program aimed at saving $141 million by cutting 6,033 City-funded jobs -- 3.6 percent of the current work force. These jobs would be eliminated permanently and, therefore, the amounts saved would recur in subsequent years. Indeed, it is crucial that all the 1980 deficit reduction actions involve recurring savings, in light of the large potential gaps in 1981 and 1982.

The City's gross attrition rate recently has been running at considerably higher rates than 3.6 percent, and our judgment is that net attrition in this range should be possible. Specifically, approximately 60 percent of the proposed 1980 attrition plan involves teachers in the school system. In turn, this reflects a projected decline in enrollment of approximately 45,000 students. Enrollment is declining this year at an annualized rate of approximately that amount, and demographic factors indicate that such reductions probably will continue.

There are two uncertainties, however, regarding the Level I attrition plan. The first stems from the changes which the 95th Congress made in the CETA program. These may require the City to phase out up to 3,000 CETA-funded jobs by October 1, 1979. In turn, this will make attainment of the 1980 net attrition goal more difficult. To offset this risk, the City has increased its $100 million general reserve by approximately $50 million annually,

through 1982, to compensate for any shortfalls in CETA funding and the related costs of personnel transfers. These reserve provisions may make unnecessary the proposed $57 million additional special reserve generated by the second part of the Level I.

The second uncertainty simply concerns the implementation of this attrition program. We have not received a plan detailing the necessary administrative actions. Treasury requested detail on the City's attrition control plans, as well as quarterly reports on their progress.

The second part of the Level I program involves $57 million of deficit reduction actions, other than attrition, principally as follows:

-- Reduction of $23 million in previously budgeted procurement of equipment and supplies. Last year, actual spending on procurement was approximately $200 million below budget. Shortfalls are continuing this year and probably will substantially exceed this $23 million figure. Nevertheless, we are awaiting sufficient detail on the implementation of these reductions in procurement.

-- Increases in licensing fees and other revenues of $9 million.

-- A $25 million reduction in the reserve against disallowed claims against the State and/or Federal Government. The City has a $400 million accumulated reserve in this category, and recent disallowances have been small. Treasury staff and Arthur Andersen believe, therefore that this proposed reduction in the 1980 reserve is acceptable.

Level II involves net attrition of 2,842 more City-funded jobs to save $52 million. This additional attrition primarily would occur in agencies largely untouched by the Level I attrition program. In particular, 40 percent of the further attrition would occur in the police, fire, sanitation and corrections departments. Again, the rates of gross attrition in these and the other affected agencies is sufficiently high to permit these amounts of net attrition.

Treasury's judgment is that the City actions involved in this overall $250 million program are generally sound. The attrition-related steps account for 77 percent of the total savings and these obviously involve recurring savings. The remaining steps are somewhat less permanent, but also can be recurring.

Increases in 1980 State Aid

Governor Carey has consistently supported increases in State aid in amounts necessary to help close New York's budget gaps. By any standard, his record of providing needed assistance to the City -- State fiscal relief and otherwise -- is solid.

As noted earlier, the City's 1980 PEG program projects another major increase in State aid for that year, *i.e.*, $192 million. Governor Carey's position is that: (1) the State's Executive Budget, which was released last week, includes increased aid to the City of approximately $100 million; and (2) that he will support further increases via supplemental appropriations, to a total of $200 million, if the City cannot otherwise balance its budget.

City and State officials are continuing to debate the recently submitted State budget. They have not yet reached agreement on the exact amounts of increased aid which are contained in it. Treasury is awaiting their conclusions and is continuing with its own analysis.

It is clear, however, that the State has the financial capacity in 1980 to provide up to $200 million in increased aid to the City. It also is clear that the combination of proposed changes in the aid-to-education formula and further City savings from the State take-over of the supplementary security income program will involve major budget relief for the City in 1980, leaving aside other State actions which also are likely. Finally, Governor Carey's commitment on increased amounts up to $200 million also seems firm.

We have concluded, therefore, that a major increase in 1980 State aid to New York can be expected. Governor Carey's representatives have informed us that the minimum increase will approximate $100 million and that the Governor will support larger amounts, if they are needed. This compares to the $192 million of total State and Federal aid, which is needed after the Level I and Level II City actions.

Federal Aid to New York City

Treasury's preliminary analysis indicates that the Carter Administration's 1980 budget proposes to increase total Federal aid to the City by approximately $200 million. This does not include a major increase in welfare and medicaid entitlements.

With the exception of the Administration's proposal on countercyclical revenue sharing, however, none of the components of this overall increase involve unrestricted fiscal assistance -- aid available to close budget deficits. In fairness, certain increases in categorical aid may involve some savings to the City, and the Administration also is working on a series of administrative actions involving fiscal relief. Indeed, we will do our best to pass the proposed countercyclical aid program, although it involves non-recurring revenue and to complete other Federal actions which will help close the 1980 deficit.

Yet, at the moment, there is not sufficient evidence to conclude that any of the proposed Federal steps can be counted on to provide recurring budget relief to the City.

Treasury Conclusions on the 1980 PEG Program

Treasury's study of the City's latest four-year financial plan has primarily addressed two questions: (1) whether the 1980 plan will result in budget balance (as defined under State law); and (2) whether the 1980 plan represents "substantial progress" toward the ultimate goal of true balance by 1982. The Guarantee Act requires the Secretary to "find" in the affirmative on these questions before further guarantees can be issued.

In view of the City's current estimates of 1980 revenues and expenditures, our preliminary conclusion is that the PEG plan will result in balance (as defined), provided Levels I and II of City actions (or equivalent measures) are implemented and reflected in the City's Executive Budget. The magnitude of the projected deficits for 1981 and 1982 combined with uncertainties about increasing levels of Federal and State aid, the 1980 wage negotiations, the impact of changes in the CETA program on the attrition goals, and the feasibility of City actions relating to the Board of Education and Health and Hospital Corporation, make

it clear that both sets of City actions are needed.

Our preliminary conclusion on the 1980 budget plan also is conditioned upon the City's supplying us and the Financial Control Board with details concerning the administrative steps required to implement the Level I and Level II programs. These will permit Treasury to monitor their implementation and to determine periodically whether additional actions will be necessary or whether rescission of planned cuts is feasible.

Let me turn now to the second key question surrounding the latest Financial Plan, i.e., are the 1981 and 1982 potential deficits manageable, or is the overall budget program too backloaded?

The 1981/1982 Budget Outlook

At the moment, Mr. Chairman, it appears that the 1981 and 1982 budget goals will be more difficult to meet than the 1980 target. Specifically, as Table III indicates, the potential deficits in those years approximate $540 million and $800 million respectively. Moreover, while these estimates assume that 1980 Level I and Level II City actions are fully implemented and recurring, they do not assume any labor cost increases in those years. As you know, the City's existing labor contract expire in mid-1980.

It is not possible to know today whether such gaps will materialize or, if so, how they will be closed. A judgment on whether deficits of that size can be closed depends on an assessment of (1) whether gaps of this size are really likely; (2) whether the City has the capacity to make further large cuts and; (3) what can be expected on State and Federal aid.

Treasury has assessed these factors in a preliminary manner and has concluded that the City's prospects for meeting its 1981/1982 budget targets are reasonable. Let me turn to a brief discussion of these key factors:

City Actions Beyond 1980

The latest Financial Plan proposes a series of City deficit reduction actions for 1981 and 1982. Mayor Koch already is committed to several of these -- the revenue increasing actions -- and has outlined a series of contingent expenditure reduction actions. These include the following:

-- The major City revenue raising action in 1981 and beyond relates to a change in the real estate tax payment schedule from quarterly to semi-annually. The City projects this change will save $32 million in each of the three years by primarily reducing seasonal loan requirements and attendant costs. This is a reasonable program and the savings would be of a recurring nature.

-- A second real estate tax action, limiting veterans exemptions, would yield approximately $7 million of annual recurring revenues to the City. Again, this change would require legislative action but the increases appear reasonable.

-- The City also has proposed a series of further expenditure reduction steps for the 1981/1982 period. These are primarily composed of further reductions in the Board of Education budget due to lower entrollment and stepped up attrition in most other City agencies. The remaining actions involve further restraint in the procurement budget and various management improvement programs.

This program of City actions is similar to the contingency plan outlined by the City on October 6, 1978, which was subsequently approved by the FCB on November 9. More detail is required, of course, before those future City actions can be fully evaluated.

It is unlikely, however, that New York can rely solely on actions like these and on personnel actions to make the needed 1981 and 1982 cuts at the City level. Our view is that Mayor Koch must begin to undertake structural reforms of the City's expenditure base. These should involve the hospital and transit systems, as well as other major functions which New York cannot fully afford any longer.

Other Reasonable Assumptions

The potential 1981 and 1982 deficits estimated in Table II reflect very conservative revenue and expenditure assumptions, except in the area of post-1980 labor cost. To put these assumptions into reasonable perspective, it is useful to consider a series of other factors which could affect the City's budget and which are not reflected in the current Financial Plan. Let me cite a few of these factors.

Non-Recurring Revenues

Presently, the City's baseline projections make no provision for non-recurring revenues. This is a fiscally prudent practice which makes sense for planning purposes. Yet, it ignores the historical perspective. Arthur Andersen and Company has prepared an analysis indicating that since 1975, the category of non-recurring revenues has averaged $200 million per year. It is likely that such benefits will continue and that, as a result, the actual 1981 and 1982 deficits may be smaller. A reasonable portion of this might be included in the out years to facilitate the City's ability to balance its budget.

Underspending

In 1978, City expenditures fell short of budgeted amounts by approximately $200 million. There are indications that this "underspending" has continued into fiscal 1979 -- just as Federal spending shortfalls occurred in 1977 and 1978.

We have asked the City to accelerate its analysis of this phenomenon to permit a detailed comparison of actual audited results to the FY 1978 budget. This would enable the City to prepare baseline projections on actual rather than prior budget figures and would identify the specific areas where underspending has occurred. In particular, it would help determine whether savings from this source will continue over the plan period.

State Aid

Another large variable in the City's plans to close its budget gaps in fiscal years 1981-1982 is the outlook for State aid in those years.

The City presently projects an increase of $200 million in 1980 State aid and that this amount be recurring through 1982. Recent conversations with State officials, however, indicate that these figures may be conservative. Aid to the City may well increase by larger amounts, particularly in the categories of aid to education and State revenue sharing. Any greater growth, of course, would reduce the deficit estimates discussed earlier.

Summary

In summary, though we are concerned with the prospects for 1981 and beyond, it is not unreasonable to assume the City will be able to balance its budget as required by the Loan Guarantee Act. In addition, Treasury and the Financial Control Board have asked the City to submit in May of this year its program to close the 1981 gap. This will give us more lead time to evaluate the City's prospects for 1981 and 1982.

Let me close by emphasizing that the City has shown the willingness and wherewithal to take whatever steps necessary to meet its statutory budget requirements. Mayor Koch's commitment to continuing this record is clear. Governor Carey remains committed to the City's solvency, as is our Administration. We are satisfied, therefore, that the City, the State and other interested parties, are making the maximum effort to solve the City's fiscal difficulties.

This concludes the prepared portion of my testimony. I will be pleased to respond to any questions at this point.

Thank you.

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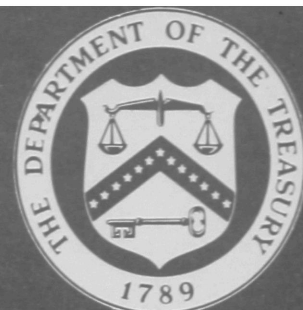

FOR IMMEDIATE RELEASE
Thursday, February 8, 1979

Contact: Alvin Hattal
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TREASURY CALLS FOR EDUCATIONAL CAMPAIGN
ON DRINKING BY PREGNANT WOMEN

The Treasury Department today called for a broad educational campaign to alert the public to the risks of alcohol consumption by pregnant women.

Treasury said it would work with other Federal agencies, including the Food and Drug Administration and the National Institute on Alcoholism and Alcohol Abuse, the alcoholic beverage industry and other interest groups to develop a program to raise the current level of awareness about this problem.

Richard Davis, Assistant Secretary of the Treasury for Enforcement and Operations, said: "Scientific evidence establishes clearly that the offspring of women who drink heavily during pregnancy could suffer mental and physical defects known as the fetal alcohol syndrome.

"Scientists disagree about the effects of moderate or binge drinking. But since we are unable to determine a safe level of drinking, it is important that the general public be made aware of the problem so they can exercise the proper cautions."

Treasury decided not to require a warning label on alcoholic beverage containers at this time since it wishes to avoid unnecessary government regulation and to give the private sector the opportunity to take appropriate action before imposing regulations. Treasury will take polls at the beginning of the campaign and after six months to a year to measure the success of the educational effort. If the campaign does not prove effective, Treasury said it would again consider requiring warning labels on alcoholic beverage containers. In addition, if on-going scientific research provides more certain evidence of the adverse effects of lower levels of alcohol consumption, warning labels will be reconsidered.

Davis said: "There is reason to believe women will review their drinking habits during pregnancy if they are aware of the possible dangers. Under the current circumstances, we believe that a broadly based educational effort is the best means to provide

them with the necessary information so that the birth defects that may result in some circumstances from drinking can be avoided."

The educational program is intended to include the distribution of a report on the effects of alcohol on the fetus, distribution of brochures to the public and to the medical profession, public service announcements on radio and television, and educational programs in the schools. The program would be designed to inform women before they are pregnant or see a doctor and to educate men so that they can be supportive of any decision involving alcohol.

Treasury will meet with interested public and private organizations to plan specific elements of the program and to coordinate the overall effort. "We want to call forth the creativity and communications skills of the alcoholic beverage industry to inform people of this problem," Davis said.

Today's measures follow from a January 1978 announcement by Treasury that it would examine the effects of alcohol consumption on offspring and decide whether government action was needed. Interested parties were asked to comment on the problem and whether it justified warning labels.

Treasury's Bureau of Alcohol, Tobacco and Firearms, which regulates the alcoholic beverage industry, received and analyzed more than 3000 comments, including medical and scientific reports. Most of the comments -- 2772 -- came from consumers. Most consumers, and industry groups, opposed warning labels, chiefly on the grounds that the problem affects a small percentage of women and that labels would be costly and ineffective. The medical profession was divided both on the effects of alcohol on pregnant women and the advisability of warning labels.

Because of the highly technical issues involved, Treasury adopted a recommendation by the President's Office of Science and Technology Policy that non-governmental experts review the comments and related evidence.

The experts were Dr. Sergio Fabro, a medical doctor with advanced degrees in biological chemistry and who is professor and director of the Fetal-Maternal Medicine Division, George Washington University Medical Center, Washington; Dr. Judith Hall, a medical doctor who is a specialist in genetics and Director of the division of Medical Genetics at Children's Orthopedic Hospital in Seattle, and Dr. Amitai Etzioni, a sociologist who is Director of the Center for Policy Research and currently a visiting fellow at the Brookings Institution.

Dr. Fabro reported that the "full blown" fetal alcohol syndrome -- consisting of central nervous system dysfunctions, growth deficiencies, a cluster of facial abnormalities and variable other major and minor malfunctions -- has been observed only in offspring of chronic alcoholic mothers. He also stated that while evidence indicates that with lower levels of alcohol consumption the full-blown syndrome is highly unlikely, some other poor pregnancy outcome (for example, low birth weight and still birth) appears possible. He said further study is needed to determine whether other than heavy drinking -- for example, two to three glasses of wine with dinner or a martini before dinner -- is harmful. He declined to offer an opinion on whether a warning label is justified.

Dr. Hall reported overwhelming evidence that the fetal alcohol syndrome exists where heavy drinking is involved and said it is probable that other more subtle deleterious effects occur in children whose mothers drink lesser amounts during pregnancy. She pointed to mental retardation as one such potential consequence. But, "this second type of the maternal fetal alcohol spectrum has not yet been fully evaluated or delineated." She recommended a warning label and a broad educational program.

Dr. Etzioni said that, in view of the present low level of understanding about the effects of alcohol on offspring, other methods of alerting the public might be more effective than a warning label. He said public policies with regard to warnings should vary depending on the strength of the data on the problem and the magnitude of the danger.

The experts reports are summarized in a Treasury progress report to be published in the Federal Register of February 9, 1979.

Previous government actions to inform the public of the risks of drinking during pregnancy included the distribution by FDA, in coordination with NIAAA, of a bulletin on the fetal alcohol syndrome to a million health professionals. FDA has also reprinted and distributed an article on the subject for consumers.

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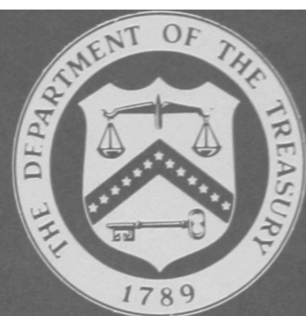

FOR RELEASE UPON DELIVERY
EXPECTED AT 10 A.M.
FEBRUARY 8, 1979

TESTIMONY OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
SENATE BUDGET COMMITTEE

Mr. Chairman and Members of this distinguished Committee:

I appreciate this opportunity to discuss with you the President's economic and budgetary plans for 1979 and 1980.

You have heard extensive testimony from other Administration witnesses concerning the general economic outlook. At Chairman Muskie's request, I will instead deal with a number of specific questions raised by the President's budgetary and other economic policy proposals.

At the outset, however, I wish to emphasize four points about the Administration's overall economic strategy.

First, the President believes that all the major tools of economic policy must now be mobilized to fight inflation. Since the deep recession of 1974-75, we have enjoyed an unprecedented recovery of employment and production, but these achievements cannot be held, much less enlarged, unless we now take firm steps to maintain the integrity of our currency, both at home and abroad.

Second, the centerpiece of our anti-inflation strategy is firm and sustained restraint on aggregate demand, effected through both fiscal and monetary policies. Over recent months, there have been warning signals of excess demand -- of tightness in selected product and labor markets. In response we must restrain both the budget deficit and the growth of the money supply. Of equal importance, we must persist with that restraint over the long term: No nation has been able to conquer inflation without the unwavering and continued support of fiscal and monetary discipline.

Third, long-term budgetary restraint will be possible only if we keep a firm check on federal spending. It is neither fair to the American people, nor politically feasible, nor economically sensible to depend on steadily escalating effective tax rates to maintain a balanced budget over the long term. The most important number in the President's budget is $531.6 billion -- the aggregate level of FY 1980 outlays. The test of fiscal restraint is whether that limit can be held. The President is prepared to use all of the powers of his office to meet that test.

Fourth, if we show long-term fiscal and monetary discipline, this economy can progress on a path of price stability and sustainable growth without a recession. The recovery remains remarkably resilient and well balanced, and the American people are showing a genuine willingness to draw together into a common effort to slow the momentum of the wage-price spiral. Responsible action on this budget can build a secure foundation for the American economy in the 1980's.

Mr. Chairman, I will devote the remainder of my testimony to the specific questions raised in your letter of January 31.

Question 1: Major changes proposed by the Administration to accelerate the payment of income and payroll taxes to the Treasury. Why didn't the Administration propose that these various changes first become effective in 1980 so that the interest savings on the public debt could be realized sooner and the Federal deficit could be reduced substantially in FY 1980? In particular, why should the proposal to accelerate employer deposits of withheld taxes -- a proposal which can be implemented by regulation without new statutory authority -- be deferred until 1981?

Answer: The budget includes several initiatives to require taxpayers to make tax payments closer to the time when tax liabilities occur. These proposals will increase receipts by $2.2 billion in 1980, $5.0 billion in 1981, and $5.3 billion in 1982. The changes will be phased in

over three years to minimize the burden on taxpayers in making the transition to the new collection procedures.

Some of the changes require legislation. Others can be implemented administratively. We will require accelerated deposits by state and local governments of withheld social security taxes in 1980, as this change merely brings state and local governments into conformity with rules now applicable to private businesses.

The Administration decided to make the other cash management improvement proposals effective at the beginning of 1981. This eases the implementation problems, for both companies and the government, and allows for careful legislative consideration. Although the proposals to accelerate employer deposits of withheld taxes will be accomplished by regulations, we delayed the effective date so that Congress would have sufficient time to exercise legislative oversight of administrative changes in conjunction with its consideration of those parts of the cash management package that do require legislative action.

If the Congress wishes to accelerate implementation of these proposals, the Administration would have no objection. However, we would object very strongly to increasing budget outlays to the extent of the accelerated revenue gains. These cash management proposals are not designed to produce artificially reduced deficit figures or to raise new money for federal programs. They are designed solely to increase the efficiency of tax administration and to save the government money.

<u>Question 2</u>: <u>The real wage insurance proposal</u>. How does the Administration justify as anti-inflationary a deficit-financed tax rebate that provides windfall gains to most recipients and whose cost could range from $2.5-$15 billion? How

high would the estimated revenue loss from real wage insurance have to be before the Administration withdrew its support from the proposal? How does the Administration arrive at its estimates of program participation and a 0.5 percentage point reduction in the inflation rate? What factors influenced the Administration's recommendations for program eligibility? Why are Federal employees eligible? How can this proposal be distinguished from the ill-fated $50 rebate that was withdrawn as inflationary in 1977?

Answer: The revenue cost of real wage insurance will be modest. The program provides a tax credit to workers in groups complying with the 7 percent wage standard. The credit would be equal to the worker's W-2 wages, up to $20,000, times the amount by which 1979 inflation exceeds 7 percent, up to 10 percent inflation. Accordingly, the revenue cost depends on the number of workers who comply and on the 1979 inflation rate. Because increased compliance directly reduces inflation, the revenue cost is self-limiting to a large extent.

We estimate 1979 inflation at 7.5 percent for the relevant period and assume wage standard compliance by 47 million workers out of 87 million workers eligible for the program. This entails $2.5 billion in revenue cost. If the compliance rate were higher, the cost would be somewhat reduced. The specter of high program costs -- e.g. $15 billion -- requires that the compliance rate and the inflation rate both be very high. This could occur only if inflation exceeded the average rate of wage increase in the economy. Since the Second World War, this has happened only once -- in 1974, when oil prices quintupled and crop failures on several continents caused food prices to explode. A repetition of these extreme conditions in 1979 is very unlikely.

As for "windfall gains", real wage insurance performs far more efficiently than most tax incentives. Whenever a tax benefit is accorded

to those who perform in a particular way -- as is the case, e.g., with the investment tax credit and the charitable deduction -- a certain proportion (usually the vast majority) of those receiving the benefit would have performed even without the benefit. In the case of real wage insurance, we estimate that about 26 million of the 47 million likely recipients would have secured wage increases of 7 percent or less in any case. However, the availability of real wage insurance, and its dampening impact on inflation, should have some helpful impact on the wage demands of even these workers. There is, at any rate, no way to identify most of these workers. It would be unfair to single out the few identifiable groups -- e.g. federal employees or workers under existing contracts -- who fall in this category. These workers have, after all, made a considerable financial sacrifice and are in compliance with the wage standard.

The Administration estimates that 47 million workers, out of 87 million eligible workers, will comply with the wage standard if real wage insurance is available. To derive this we extrapolated recent patterns, trends, and distributions of wage increase. These extrapolations reveal that about 26 million workers will be "locked in" to wage increases over 7 percent by existing union contracts or by minimum wage increases. Another 26 million will fall below 7 percent without wage restraint. Of the remaining 35 million, who would have the ability to secure increases over 7 percent, we estimate that about 60 percent -- or 21 million -- will comply with the wage standard. This includes nearly all of those who could otherwise secure increases between 7 and 8.5 percent, and a declining proportion of those who could secure larger increases. This degree of compliance would reduce the total wage bill for the economy by $10 billion or 0.7 percentage point, which in turn implies a 0.5 percentage point reduction in the inflation rate.

The Administration has designed the program's eligibility standards to be as simple, universal, and even-handed as possible. Every employee receiving a W-2 form is eligible, with the exception of those owning a substantial share of their employer company. The self-employed are excluded because they typically have discretionary authority to alter the timing and form of their income, which would open the program to abuse.

The proposal differs from the $50 rebate, and indeed any other tax cut proposal, in the most basic of ways: real wage insurance is available only to those who contribute to a lower rate of inflation. For this reason, failing to enact the proposal would add to inflation, and shifting the $2.5 billion to added spending or to a traditional tax cut would be doubly inflationary.

Question 3a: Future tax reductions

Under what circumstances would individual income tax reductions be appropriate in FY 1980? Under what circumstances would payroll tax reductions be appropriate in FY's 1980, 81, or 82?

Answer: The centerpiece of the President's anti-inflation program is sustained and concerted restraint of aggregate demand, effected through both fiscal and monetary policy. This is a long-range program, not one to be turned on and off in an attempt to fine tune the economy.

Accordingly, we do not view any tax reduction in FY 1980 as appropriate. The economy is carrying considerable forward momentum at present, and is pushing toward the danger zones in rates of resource utilization that have been associated with accelerating inflationary pressures in the past. We are forecasting a tapering of that momentum so that real growth during the course of 1979 will be only a

moderate 2-1/4 percent, followed by some reacceleration to about 3 percent during the course of 1980. The added stimulus of a tax cut in 1980 would be dangerous.

Should events depart very significantly in either direction from the path we presently foresee, then we would have to take a careful look at the situation as it emerges.

Farther ahead, it is clear that the combination of restrained growth of outlays and a progressive tax structure will make tax reductions both possible and desirable. However, the appropriate timing, size, and composition of any major tax change will depend on economic developments, the budgetary situation, and a variety of other factors which cannot be forecast with any degree of reliability at this time.

If our proposals for social security benefit reforms and hospital cost containment are enacted, a reduction in social security taxes beginning in 1981 could be considered, though this would of course have to be weighed against alternative uses of the savings.

Question 3b: Is the Administration committed to reducing taxes rather than raising spending in future years to stimulate the economy and expend the "fiscal margin" which is indicated in the Administration's 5-year budget projections?

Answer: Yes. This Administration is determined to restrain the growth of Federal expenditures and to rely principally on the private sector as the source of economic growth.

Last year at budget time, the Administration announced goals for reducing the share of Federal outlays to GNP, and we have done the same this year. We are projecting outlays at about 21 percent of GNP in FY 1980, which puts us a year ahead of the earlier schedule. This compares with 22.6 percent in FY 1976.

Question 4: Structural tax issues left unresolved last year. When will the Administration make public its proposals with respect to fringe benefits and the tax treatment of workers as either independent contractors or employees? Will either or both of these proposals be likely to substantially affect revenue collections in FY 1980? If so, do you have any preliminary estimate of the likely FY 1980 revenue impact of the proposals?

Answer: The Administration expects to make its recommendations to the Congress concerning the tax treatment of fringe benefits within the next month. Our recommendations relating to the determination of whether persons who perform services are independent contractors or employees will probably be made this spring.

Estimates of the budget impact of these proposals are difficult to make, as the figures are not available from current tax return data. However, we would not expect either proposal to affect revenue collections substantially in FY 1980. The earliest effective date of any recommendation would be January 1, 1980. To the extent either proposal involved a significant change from current practice, we could expect a further delay in the effective date.

Question 5: Balancing the Federal budget. What year would be an appropriate target for attaining a balanced budget? What unemployment and inflation rates would be consistent with budgetary balance in your target year? Should the Congress adopt a formula approach to balancing the budget such as a Constitutional amendment mandating budetary balance?

Answer: The Administration wishes to achieve budget balance at acceptable levels of taxation as soon as possible.

In the FY 1980 budget documents, we have shown rough balance in FY 1981, assuming outlays at current services levels, with unemployment at 5.4 percent in the fourth quarter of calendar

1981, inflation at 5.2 percent, measured from the fourth quarter of 1980 to the fourth quarter of 1981, and real growth at 4.6 percent.

It is, however, premature to make final decisions on the FY 1981 budget. The unemployment, inflation, and growth numbers cited for 1981 are assumptions that will no doubt require refinement in light of future economic developments. Economic science has not reached the point where forecasting two years ahead is a reliable exercise.

Equally important, it is possible that tax reductions may be appropriate for FY 1981, which would move the budget off balance in the absence of even greater spending restraint. Other than economic circumstances, the chief obstacle to budget balance is the difficulty in restraining outlays. Outlays must be steadily reduced as a percentage of GNP if balance is to be attained at levels of taxation acceptable to the American people over the long term.

It would be a serious error to seek budget balance by means of a statutory or Constitutional formula.

Both the actual and the desirable levels of outlays and receipts depend, at any particular time, on rates of economic growth, of inflation, and of unemployment, none of which are predictable with accuracy even in the short term. A legal mandate for balance would require very frequent and highly disruptive changes in tax laws and in federal program levels. This would create great uncertainties in the private sector and serious inefficiencies in the public sector. In times of economic downturn, such a legal mandate would guarantee an even deeper recession, for we would have to raise tax rates as incomes and revenues fell. Fiscal policy would become a source of economic policy.

A formula approach would also invite endless abuse and evasion. It is a relatively easy matter to remodel spending programs into off-budget expenditures, loans, guarantees, and the like. A balanced budget law might well end up balancing an almost meaningless budget.

The current congressional budget process provides a fully adequate formal mechanism for controlling spending and the deficit. The real task before us is not to write new statutes and Constitutional amendments about the need for budget balance but to use the existing legal machinery to achieve balance in fact. The test of fiscal restraint is not what we say but what we do.

Question 6: "Crowding out".

To what extent will Treasury financing in FY 1979 and FY 1980 "crowd out" other borrowers, in particular, businesses borrowing to purchase new plant and equipment? What would the Federal Reserve have to do to avoid or offset the "crowding out" phenomenon?

Answer: Federal credit demands will be somewhat lower in calendar year 1979 than those of 1977 and 1978 and will be considerably lower in 1980. Direct Federal borrowing from the public in 1979 will be reduced to an estimated 12 percent of the total and even further to about 9 percent, in 1980, substantially below the over 14 percent level of 1977. Even if one adds to the total of direct Federal borrowing the credit demands of Government sponsored agencies, such as FNMA and the Federal Home Loan Banks, the Federal government share of total credit flows drops from the 21 percent in 1977 to an estimated 15 percent in 1980. Given the decline in federal borrowing and the tapering off in the demand for consumer credit which accompanies the somewhat slower economic growth, we see the business share of total credit flows increasing to about 37 percent in 1979 and 40 percent in 1980, up from its 32 percent and 35-1/2 percent shares in 1977 and 1978. Because of the fiscal restraint

demonstrated in the budget, the Federal Reserve will be able to keep the monetary aggregates under firm control without choking off flows of credit to the business sector.

Question 7: Anti-inflation initiatives.

Aside from adhering to the Administration's budget and enacting real wage insurance, what do you recommend that the Congress do this year to fight inflation? What can the Federal Government do to boost productivity?

Answer: It is essential that the Federal Government provide leadership in the battle against inflation. In practice, this means more effective allocation of limited Federal budgetary and financial resources. Full Congressional support and initiative is needed in this important effort. Ineffective programs must be eliminated and continuing programs made more effective.

The most urgent economy measure proposed in the budget is hospital cost containment for medicare and medicaid. Enactment of hospital cost containment would save nearly $25 billion over the 1980-82 period, including $9.8 billion in Federal outlays.

To improve productivity growth will require a long-term effort. The tax bill, passed last year, contained substantial incentives for investment. This will help. In addition, the government must be careful not to impose excessive regulatory burdens on the private sector. The Administration has established procedures to coordinate regulatory activities, to develop a calendar of scheduled regulations, and generally to improve the regulatory process. The Congress may wish to examine how legislation in the regulatory area can be made less burdensome on the private sector. Improvements in the regulatory area will be beneficial both to our fight against inflation and our emphasis on increased productivity.

In the long-run productivity improvement will also be fostered by the increased budget outlays in support of basic research. The Administration believes that even in a period of constrained budget growth the government must sustain support of basic research as a long-term investment in the Nation's future. The President's proposed 1980 budget provides for a 2 percent increase in real outlays for this vital category. Moreover, this increase follows upon even stronger increases which were budgeted in 1978 and 1979.

Other governmental actions designed both to reduce inflation and promote productivity growth are the employment and training programs for the young, the unskilled and the disadvantaged, which will equip this segment of the workforce with the necessary skills for today's job market. Especially important are the private sector initiative program and the targeted jobs tax credit.

As fiscal and economic conditions permit, in future years consideration will be given to other measures that the federal government can take to increase investment, foster research and development and promote productivity growth. The most important step we can take to stimulate investment however, is to insure stable economic growth and reduced inflation.

Question 8: Crude oil pricing. Does the Administration economic forecast assume decontrol of domestic crude oil prices? If so, what will be the inflationary impact of this action? If not, how does the President propose to lift domestic oil prices to world levels, as promised at the July 1978 Bonn Summit meetings.

Answer: Our inflation forecasts include the impact of recently announced OPEC price increases for imported crude oil, but they do not seek to anticipate the impact of possible domestic price decontrol scenarios on the inflation rate. The President has not yet decided upon

the methods or timing of price adjustments for domestic oil. The inflation impacts involved cannot be predicted with precision and depend critically on the details of method and timing, and also on background conditions in domestic and international oil markets. As an extremely rough rule of thumb, complete decontrol of domestic crude oil prices would raise the CPI by 0.6-to-1.0 percentage point. This one-time effect would be diffused over several years in the case of phased decontrol -- i.e. raising the inflation rate by several tenths of a point each year until world price levels are reached. The initial inflationary impact is a temporary phenomenon resulting from a one-time adjustment of domestic prices to world levels. This inflationary effect would be offset, perhaps very substantially, by the consequent reduction in our oil import bill, which would strenthen the dollar and reduce price pressures on international oil markets, both of which effects are anti-inflationary. In the long-term, world pricing of domestic oil would improve the efficiency of our industrial economy, encourage conservation, increase domestic energy supplies, strengthen the trade balance and the dollar, and weaken OPEC's leverage on oil prices.

Question 9: The outlook for merchandise trade and the dollar. What are the prospects for substantially narrowing our merchandise trade deficit from last year's high level? What is the outlook for the value of the dollar on foreign exchange markets this year and next? How much of the $30 billion "dollar defense fund" has been used? What will the Administration do if and when those resources are depleted? What is the appropriate role of monetary policy in supporting the dollar?

Answer: Conditions in the foreign exchange market have clearly improved since November 1. The severe and persistent disorder which characterized the markets in October has been overcome. The dollar has appreciated substantially from its lows although there have been up and down movements in rates from day to day.

The situation is still unsettled, however. Current uncertainties continue to generate nervousness. One of the principal sources of uncertainty in the market, for instance, is the impact of recent political developments abroad on oil supplies.

While daily movements in foreign exchange rates are to be expected as traders react to current developments, the United States is determined to prevent a reemergence of disorderly conditions. We have substantial resources for intervention -- fully adequate -- and we will not hesitate to use them to achieve our objective. The other participants in the joint operations -- Germany, Switzerland and Japan -- have committed their own resources and there is no quantitative ceiling on the total resources available.

We do not disclose the amount of our intervention in the foreign exchange market on a current basis. We do, however, publish this information quarterly. The report on "Treasury and Federal Reserve Foreign Exchange Operations," which will be released in early March, will provide information on our intervention in the November-January period.

Our intervention policy will work if traders are convinced that our policies to reduce domestic inflation and reduce our currennt account deficit are strong enough to do the job and that we are committed to maintain those policies as long as needed. We intend to make sure our policies are strong enough. We intend to maintain them as long as necessary. In this context, monetary restraint is an important and necessary complement to fiscal austerity and must be maintained until the inflation problem is brought firmly under control.

I think the outlook for the dollar is improving. Our goods should be more competitive both at home and abroad this year. Our export markets will be growing faster than our own economy for the first time in five years.

Our trade balance has showed marked improvement since the first quarter of 1978. Export volumes have risen strongly since March 1978; growth in non-oil import volume has slowed down substantially.

In 1979 we expect continued strong export growth and a very small increase in import volume. Although the oil price rise will add about $4 billion to oil imports, the trade deficit should decline to about $26 to $28 billion for the year as a whole, down from $34 billion in calendar 1978. Owing to our growing surplus in services, the current account deficit could drop by about 50 percent from the roughly $17 billion estimated for 1978.

Question 10: The Administration proposal to reduce agricultural export credit. How can this proposed budget cut be justified in light of our large merchandise trade deficit, prospects for increased sales of farm products to the Peoples Republic of China, and the commitment of the Congress to using export credit to support farm incomes?

Answer: The reduction in the CCC budget for export credits is part of the Administration's overall commitment to reduce the federal budget deficit. It should not, however, be construed as being inconsistent with the Administration's strong commitment to agricultural exports to support farm income. We expect that private financing--which after all has always financed the bulk of agricultural exports--will be readily available and that agricultural exports will continue at a high level.

The decision to reduce the amount CCC export credits was taken in light of several important factors:

1) The new CCC Non-Commercial Risk Assurance Program will make possible a shift in financing of agricultural products from federal to private sources. We believe the

use of the guarantee program will attract greater private resources towards financing agricultural exports.

2) The Administration's goal of greater efficiency in financing agricultural exports will be enhanced because the $800 million budgeted for that purpose will be used with great care. We expect future CCC credits to be carefully targeted towards sales where there is a strong indication of additional exports beyond what the private financial market will support.

3) The strengthening of export demand for U.S. agricultural goods in 1980, as the excess of world supply relative to demand diminishes, will reduce the need to stimulate exports by credit inducements.

In any event, the budget proposal may be reevaluated if warranted by world supply and demand for agricultural products in FY 1980 and by the experience to be gained with the CCC Non-Commerical Risk Assurance Program.

Question 11: Appropriations for the IMF quota increase. When do we expect Congress to appropriate the IMF quota increase proposed for calendar year 1979? Why is no provision made for this $5 billion program in the FY 1980 budget or out-year estimates?

Answer: The members of the IMF have agreed to a 50 percent increase in IMF quotas, from roughly $50 billion to $75 billion. I consider this increase very important to the U.S. and to the world economy, and to a smoothly functioning monetary system during the years ahead.

The proposed increase in the U.S. quota is 4.2 billion of SDR's--from 8.4 billion to 12.6 billion--an increase of approximately 5.4 billion in dollar terms. The deadline for consent to the quota increase is November 1, 1980.

The Administration intends to submit legislation authorizing U.S. acceptance of this quota increase as soon as possible. We have not, however, determined a precise timetable. As you know, Mr. Chairman, during Congressional consideration last year of U.S. participation in the IMF Witteveen Facility, questions arose concerning the budgetary and appropriations treatment of the U.S. quota in the IMF. The quota differs in some important respects from our participation in the Witteveen Facility, and treatment of the quota raises a number of complex questions relating to our participation in the IMF. We intend to consult fully with Congress on these questions before submitting authorizing legislation or any budgetary requests in connection with the proposed increase in the U.S. quota. We look forward to working with the Committee in this effort, looking to prompt development of a specific legislative request.

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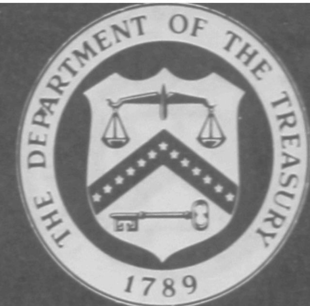

FOR IMMEDIATE RELEASE
February 8, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY TO START ANTIDUMPING INVESTIGATION ON CERTAIN STEEL I-BEAMS FROM BELGIUM

The Treasury Department today said it will start an antidumping investigation of imports of certain steel I-beams from Belgium.

Treasury's announcement followed summary investigations conducted by the U. S. Customs Service after receipt of a petition filed by the Connors Steel Co. alleging that a firm in Belgium is dumping certain steel I-beams in the United States.

The petition alleges that imports of certain steel I-beams are being sold in the United States at "less than fair value." (Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market.) The Customs Service will investigate the matter and make a tentative determination by August 9, 1979.

If sales at less than fair value are determined by Treasury, the U. S. International Trade Commission will subsequently decide whether they are injuring or likely to injure a domestic industry. (Both sales at less than fair value and injury must be determined before a dumping finding is reached. If dumping is found, a special antidumping duty equal to the difference between the price of the merchandise at home or in third countries and the price to the United States is imposed.)

Notice of the start of these investigations will appear in the Federal Register of February 9, 1979.

Imports of certain steel I-beams from Belgium in 1978 were valued at about $5 million.

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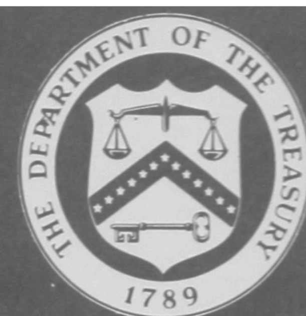

FOR RELEASE AT 4:00 P.M. February 9, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,000 million, to be issued February 22, 1979. This offering will result in a pay-down for the Treasury of about $ 200 million as the maturing bills are outstanding in the amount of $6,207 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,000 million, representing an additional amount of bills dated November 24, 1978, and to mature May 24, 1979 (CUSIP No. 912793 Y6 7), originally issued in the amount of $2,904 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated February 22, 1979, and to mature August 23, 1979 (CUSIP No. 912793 2H 8).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing February 22, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $ 3,472 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, 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, Friday, February 16, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

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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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders 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 on all accepted tenders 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. 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.

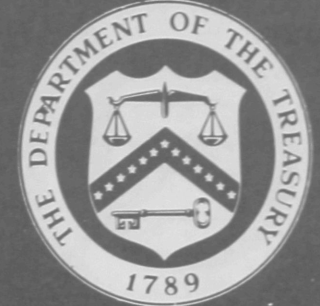
Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action 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 weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt on February 22, 1979, in cash or other immediately available funds or in Treasury bills maturing February 22, 1979. Cash adjustments will be made for differences between the par value of the 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 these bills 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 these bills (other than life insurance companies) must include in his or her 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 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 IMMEDIATE RELEASE February 9, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,801 million of 13-week Treasury bills and for $2,902 million of 26-week Treasury bills, both series to be issued on February 15, 1979, 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 17, 1979			26-week bills maturing August 16, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.669	9.222%	9.57%	95.283	9.330%	9.93%
Low	97.654	9.281%	9.64%	95.275	9.346%	9.95%
Average	97.660	9.257%	9.61%	95.277	9.342%	9.94%

Tenders at the low price for the 13-week bills were allotted 81%.
Tenders at the low price for the 26-week bills were allotted 18%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 29,810,000	$ 29,810,000	$ 35,245,000	$ 15,245,000
New York	4,191,220,000	2,271,970,000	5,566,735,000	2,380,895,000
Philadelphia	19,090,000	19,090,000	12,480,000	12,480,000
Cleveland	60,210,000	57,360,000	87,060,000	12,060,000
Richmond	18,325,000	17,135,000	10,715,000	9,715,000
Atlanta	24,580,000	24,580,000	16,260,000	15,460,000
Chicago	186,110,000	85,760,000	466,400,000	220,900,000
St. Louis	45,630,000	32,060,000	55,375,000	32,375,000
Minneapolis	14,575,000	14,575,000	13,790,000	1,790,000
Kansas City	31,345,000	31,345,000	24,065,000	16,930,000
Dallas	9,350,000	9,350,000	5,505,000	5,505,000
San Francisco	245,660,000	195,660,000	366,845,000	166,845,000
Treasury	12,335,000	12,335,000	11,940,000	11,940,000
TOTALS	$4,888,240,000	$2,801,030,000 a/	$6,672,415,000	$2,902,140,000 b/

a/Includes $373,675,000 noncompetitive tenders from the public.
b/Includes $177,830,000 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 IMMEDIATE RELEASE
February 12, 1979

Contact: Alvin M. Hattal
202/566-8381

INCOME TAX TREATY SIGNED BETWEEN
THE UNITED STATES AND HUNGARY

The Treasury Department today announced the signing of a treaty between the United States and the People's Republic of Hungary to avoid the double taxation of income. The treaty was signed in Washington by Secretary of the Treasury W. Michael Blumenthal and Minister of Finance of the People's Republic of Hungary Lajos Faluvegi. The treaty will be submitted to the U. S. Senate for its advice and consent to ratification.

The proposed treaty will be the first such treaty concluded between the United States and the People's Republic of Hungary. It is intended to facilitate economic and cultural relations between the two countries.

The treaty clarifies the rules governing income tax jurisdiction and sets certain limits on the rights of each country to tax income derived within its territory by residents of the other country. For example, the treaty provides for exemption at source of interest and royalties derived by a resident of the other country. It also limits the tax on dividends paid to a resident of the other country to 15 percent in general and to 5 percent on dividends paid to a parent corporation. Employees of U. S. companies will generally not become subject to tax by Hungary unless they remain there more than six months of the year, and employees of Hungarian enterprises will be exempt from U. S. income tax under the same conditions.

The treaty also ensures nondiscriminatory taxation and provides for exchanges of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation and prevent fiscal evasion with respect to taxes on income.

The treaty will enter into force as soon as the parties have notified each other that their respective constitutional requirements have been met. The provisions affecting withholding taxes will then take effect for amounts paid on or after the first day of the second month after the treaty enters into force, and the other provisions will take effect as of January 1 of the year following entry into force.

B-1399

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CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE HUNGARIAN PEOPLE'S REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the Hungarian People's Republic, desiring to further expand and facilitate mutual economic relations, have resolved to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, and have agreed as follows:

Article 1

PERSONAL SCOPE

1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in this Convention.

2. Notwithstanding any provision of this Convention except paragraph 3 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Fiscal Domicile)) and citizens (including, in the case of the United States, former citizens) as if this Convention had not come into effect.

3. The provisions of paragraph 2 shall not affect:

a) the benefits conferred by a Contracting State under paragraph 2 of Article 15 (Pensions), Articles 20 (Relief from Double Taxation), 21 (Non-discrimination), and 22 (Mutual Agreement Procedure); and

b) the benefits conferred by a Contracting State under Articles 16 (Government Service), 17 (Teachers), 18 (Students and Trainees) and 24 (Effect of Convention on Diplomatic and Consular Officials, Domestic Laws, and Other Treaties), upon individuals who are neither citizens of, nor have immigrant status in, that State.

Article 2

TAXES COVERED

1. This Convention shall apply to taxes on income imposed on behalf of each Contracting State.

2. The existing taxes to which this Convention shall apply are:

   a) In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations, but excluding the accumulated earnings tax and the personal holding company tax.

   b) In the case of the Hungarian People's Republic:

      i) The general income tax,

      ii) The income tax on intellectual activities,

      iii) The profit tax,

      iv) The profit tax on economic associations with foreign participation,

      v) The enterprises special tax,

      vi) The levy on dividends and profit distributions of commercial companies,

      vii) The profit tax on state-owned enterprises, and

      viii) The contribution to communal development, but only to the extent imposed in respect of income taxes covered by this Convention.

3. The Convention shall apply also to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the

existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws and shall notify each other of any official published material concerning the application of this Convention, including explanations, regulations, rulings, or judicial decisions.

4. For the purpose of Article 21 (Non-discrimination), this Convention shall also apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof. For the purpose of Article 23 (Exchange of Information), this Convention shall also apply to taxes of every kind imposed by a Contracting State.

Article 3

GENERAL DEFINITIONS

1. In this Convention, unless the context otherwise requires:

   a) The term "person" includes an individual, a partnership, a company or juridical person, an estate, a trust, and any other body of persons;

   b) The term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

   c) The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

d) The term "nationals" means:

i) All individuals possessing the citizenship of a Contracting State, and

ii) All legal persons, partnerships and associations deriving their status as such from the law in force in a Contracting State;

e) The term "international traffic" means any transport by a ship or aircraft, except where such transport is solely between places in the other Contracting State;

f) The term "competent authority" means:

i) In the case of the United States, the Secretary of the Treasury or his delegate, and

ii) In the case of the Hungarian People's Republic, the Minister of Finance or his delegate;

g) i) The term "United States" means the United States of America, and

ii) When used in a geographical sense, the term "United States" does not include Puerto Rico, the Virgin Islands, Guam, or any other United States possession or territory; and

h) The term "Hungarian People's Republic", when used in a geographical sense, means the territory of the Hungarian People's Republic.

2. As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires and subject to the provisions of Article 22 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Convention.

Article 4

FISCAL DOMICILE

1. For purposes of this Convention, the term "resident of a Contracting State" means any person who, under the law of that State, is liable to taxation therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature; provided, however, that:

   a) this term does not include any person who is liable to tax in that Contracting State in respect only of income from sources therein or capital situated in that State; and

   b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax as the income of a resident of the Contracting State, either in its hands or in the hands of its partners or beneficiaries.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then the individual's tax status shall be determined as follows:

   a) The individual shall be deemed to be a resident of the Contracting State in which the individual has a permanent home available to him. If the individual has a permanent home available to him in both Contracting States or in neither Contracting State, the individual shall be deemed to be a resident of the Contracting State in which the individual's center of vital interests is located;

b) If the Contracting State in which the individual's center of vital interests is located cannot be determined, the individual shall be deemed to be a resident of that Contracting State in which the individual has an habitual abode;

c) If the individual has an habitual abode in both Contracting States or in neither of them, the individual shall be deemed to be a resident of the Contracting State of which the individual is a national; and

d) If the individual is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then if it is created or organized under the laws of a Contracting State or a political subdivision thereof, it shall be treated as a resident of that State.

4. Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavor to settle the question and to determine the mode of application of the Convention to such person.

5. For purposes of this Convention, an individual who is a national of a Contracting State shall also be deemed to be a resident of that State if (a) the individual is an employee of that State or an instrumentality thereof in the other Contracting State or in a third State; (b) the individual is engaged in the performance of governmental functions for the first-mentioned State; and (c) the individual is

subjected in the first-mentioned State to the same obligations in respect of taxes on income as are residents of the first-mentioned State. The spouse and minor children residing with the employee and subject to the requirements of (c) above shall also be deemed to be residents of the first-mentioned State.

Article 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business or production through which the activities of an enterprise are wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

   a) a place of management;

   b) a branch;

   c) an office;

   d) a factory;

   e) a workshop; and

   f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, shall constitute a permanent establishment only if it lasts more than 24 months.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

   a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on for the enterprise any other activity if it has a preparatory or auxiliary character; and

f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs a) to e) of this paragraph.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting on behalf of an enterprise and has, and habitually exercises in a Contracting State, an authority to conclude contracts in the name of such enterprise, that enterprise shall be deemed to have a permanent establishment in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised at a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on

business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 6

INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

1. Income derived by a resident of a Contracting State from immovable property (real property) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 7

BUSINESS PROFITS

1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in that other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

3. In the determination of the business profits of a permanent establishment, there shall be allowed as deductions those expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the

part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. No business profits shall be attributed to a permanent establishment by reason of:

a) the mere purchase by that permanent establishment of goods or merchandise for the enterprise, or

b) the mere delivery to the permanent establishment of goods or merchandise for its use.

5. Where business profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8

SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that State.

2. For purposes of this Article, profits from the operation of ships or aircraft in international traffic include profits derived from the rental on a full or bareboat basis of ships or aircraft operated in international traffic if such rental profits are incidental to other profits described in paragraph 1.

3. Profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of

goods or merchandise in international traffic shall be taxable only in that State.

4. The provisions of this Article shall also apply where the enterprise has an agency in the other State for the transportation of goods or persons, but only to the extent of activities directly connected with the business of shipping and aircraft transportation, including auxiliary activities connected therewith.

Article 9

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

a) 5 percent of the gross amount of the dividends if the beneficial owner is a company which owns, directly or indirectly, at least 10 percent of the voting stock of the company paying the dividends;

b) in all other cases, 15 percent of the gross amount of the dividends.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from

shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the taxation law of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the recipient of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), as the case may be, shall apply.

5. Where a company is a resident of a Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as

a) such dividends are paid to a resident of that other State,

b) the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, or

c) such dividends are paid out of profits attributable to a permanent establishment which such company had in that other State, provided that at least 50 percent of such company's gross income from all sources was attributable to a permanent establishment which such company had in that other State.

Where subparagraph c) applies and subparagraphs a) and b) do not apply, any such tax shall be subject to the limitations of paragraph 2.

Article 10

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State.

2. The term "interest" as used in this Convention means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to bonds or debentures.

3. The provisions of paragraph 1 shall not apply if the person deriving the interest, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), as the case may be, shall apply.

Article 11

ROYALTIES

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience.

3. The provisions of paragraph 1 shall not apply if the person deriving the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), as the case may be, shall apply.

Article 12

CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property, as defined in paragraph 2 of Article

6 (Immovable Property), situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in the other State. However, gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated by such enterprise in international traffic shall be taxable only in that State.

3. Gains from the alienation of any property other than those mentioned in paragraphs 1 and 2, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 13

INDEPENDENT PERSONAL SERVICES

1. Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State unless such services are performed in the other Contracting State and

   a) the individual is present in that other State for a period or periods aggregating more than 183 days in the taxable year concerned, or

b) the individual has a fixed base regularly available to him in that other State for the purpose of performing his activities, but only so much of the income as is attributable to that fixed base.

2. The term "personal services" includes, especially, independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists, artistes, athletes and accountants.

Article 14

DEPENDENT PERSONAL SERVICES

1. Subject to the provisions of Articles 15 (Pensions) and 16 (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the taxable year concerned, and

b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration in respect of an employment as a member of the regular complement of a ship or aircraft operated by an enterprise of a Contracting State in international traffic may be taxed only in that Contracting State.

Article 15

PENSIONS

Subject to the provisions of paragraph 2 of Article 16 (Government Services),

1. pensions and other similar remuneration beneficially derived by a resident of a Contracting State in consideration of past employment shall be taxable only in that State, and
2. social security payments and other public pensions paid by a Contracting State to an individual who is a resident of the other Contracting State or a citizen of the United States shall be taxable only in the first-mentioned Contracting State.

Article 16

GOVERNMENT SERVICE

1. a) Remuneration, other than a pension, paid by a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to

that State or subdivision or local authority thereof shall be taxable only in that State.

b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident of that other Contracting State who:

i) is a national of that State; or

ii) did not become a resident of that State solely for the purpose of performing the services.

2. a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof shall be taxable only in that State.

b) However, such pension shall be taxable only in the other Contracting State if the recipient is a national of and a resident of that State.

3. The provisions of Articles 13 (Independent Personal Services), 14 (Dependent Personal Services), and 15 (Pensions), as the case may be, shall apply to remuneration and pensions in respect of services rendered in connection with any business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 17

TEACHERS

1. Where a resident of one of the Contracting States is invited by the Government of the other Contracting State, a political subdivision

or a local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to that other Contracting State for a period not expected to exceed 2 years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution, and such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution shall be exempt from tax by that other Contracting State for a period not exceeding 2 years from the date of his arrival in that other Contracting State.

2. This Article shall not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

Article 18

STUDENTS AND TRAINEES

1. Payments which a student, apprentice or business trainee who is, or was immediately before visiting a Contracting State, a resident of the other Contracting State and who is present in the first-mentioned Contracting State for the purpose of his full-time education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State provided that such payments are made to him from sources outside that State.

2. An individual to whom paragraph 1 applies may elect to be treated for tax purposes as a resident of the first-mentioned State. The election shall apply to all periods during the taxable year of the election and subsequent taxable years during which the individual

qualifies under paragraph 1, and may not be revoked except with the consent of the competent authority of that State.

Article 19

ALL OTHER INCOME

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.

Article 20

RELIEF FROM DOUBLE TAXATION

1. In the case of the United States, double taxation shall be avoided as follows: In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income the appropriate amount of tax paid to the Hungarian People's Republic; and, in the case of a United States company owning at least 10 percent of the voting stock of a company which is a resident of the Hungarian People's Republic from which it receives dividends in any taxable year, the United States shall allow as a credit against the United States tax on income the appropriate amount of income tax paid to the Hungarian People's Republic by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of income tax paid to the Hungarian People's Republic, but the

credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For purposes of applying the United States credit in relation to tax paid to the Hungarian People's Republic, the taxes referred to in paragraphs 2 b) and 3 of Article 2 (Taxes Covered) shall be considered to be income taxes.

2. In the case of the Hungarian People's Republic, double taxation shall be avoided as follows:

a) Where a resident of the Hungarian People's Republic:

i) derives income which, in accordance with the provisions of this Convention other than paragraph 2 of Article 1 (Personal Scope), may be taxed in the United States, or

ii) derives income from sources within the United States which may be taxed only by reason of paragraph 2 of Article 1 (Personal Scope),

the Hungarian People's Republic shall, subject to the provisions of subparagraphs b) and c), exempt such income from tax.

b) Where a resident of the Hungarian People's Republic derives items of income which, in accordance with the provisions of paragraph 2 of Article 9, may be taxed in the United States, the Hungarian People's Republic shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in the United States. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from the United States.

c) Where in accordance with any provision of the Convention income derived by a resident of the Hungarian People's Republic is exempt from tax in the Hungarian People's Republic, the Hungarian People's Republic may nevertheless, in calculating the amount of tax on the remaining income of such resident, take into account the exempted income.

Article 21

NON-DISCRIMINATION

1. The nationals of a Contracting State, whether or not they are residents of one of the Contracting States, shall not be subjected in the other State to any taxation or any requirement connected therewith, which is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. For purposes of the preceding sentence, nationals who are subject to tax by a Contracting State on worldwide income are not in the same circumstances as nationals who are not so subject.

2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This Article shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

3. Interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State

shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

5. In this Article the term "taxation" means taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

Article 22

MUTUAL AGREEMENT PROCEDURE

1. Where a resident or national of a Contracting State considers that the actions of one or both of the Contracting States result or will result for it in taxation not in accordance with this Convention, it may, notwithstanding the remedies provided by the national laws of those States, present its case to the competent authority of the Contracting State of which it is a resident or national.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the national laws of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

5. The competent authorities of the Contracting States may prescribe regulations to carry out the purposes of this Convention.

Article 23

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention or of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is not contrary to this Convention. The exchange of information is not restricted by Article 1 (Personal Scope). Any information received by a Contracting State shall be treated as secret in the same manner as

information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes which are the subject of the Convention. Such persons or authorities shall use the information only for such purposes. These persons or authorities may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on one of the Contracting States the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

b) to supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

3. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State and were being imposed by that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of

witnesses and copies of unedited original documents (including books, documents, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of such other State with respect to its own taxes.

Article 24

EFFECT OF CONVENTION ON DIPLOMATIC AND CONSULAR OFFICIALS, DOMESTIC LAWS, AND OTHER TREATIES

1. Nothing in this Convention shall affect the taxation privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

2. This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded--

   a) by the laws of either Contracting State, or

   b) by any other agreement between the Contracting States.

Article 25

ENTRY INTO FORCE

1. This Convention shall be subject to ratification or approval in accordance with the applicable procedures of the Governments of the Contracting States and it shall enter into force as soon as the parties have notified one another that their respective constitutional requirements have been met.

2. The provisions of this Convention shall have effect:

a) In respect of tax withheld at the source, to amounts paid or credited on or after the first day of the second month next following the date on which this Convention enters into force,

b) In respect of other taxes, to taxable periods beginning on or after the first day of January next following the date on which this Convention enters into force.

Article 26

TERMINATION

This Convention shall remain in force until terminated by the Government of one of the Contracting States. The Government of either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have effect:

1. In respect of tax withheld at the source, to amounts paid or credited on or after the first day of January next following the expiration of the 6 months' period;
2. In respect of other taxes, to taxable periods beginning on or after the first day of January next following the expiration of the 6 months' period.

DONE at Washington in duplicate, both in the English and Hungarian languages, the two texts having equal authenticity, this 12th day of February 1979.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:	FOR THE GOVERNMENT OF THE HUNGARIAN PEOPLE'S REPUBLIC:
W. Michael Blumenthal Secretary of the Treasury	Lajos Faluvegi Minister of Finance

February 12, 1979

Excellency:

In connection with the Income Tax Convention signed today, I should like to state our understanding of the agreement reached by the delegations of the United States of America and of the Hungarian People's Republic concerning the application of certain provisions of the Convention:

1. In connection with Article 9, subparagraph 5 c), it is understood that Hungary will not impose a tax in such cases.

2. Income (other than income from immovable property) will be taxed in accordance with the provisions of Article 7 and Article 13, rather than in accordance with the provisions of Article 19, if the person deriving the income, being a resident of one Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base.

3. In the case of dealings between an enterprise of one Contracting State and a related enterprise of the other Contracting State that involve conditions that differ from those that would have been made between independent enterprises, each Contracting State may apply its internal law to distribute, apportion or allocate income, deductions,

His Excellency
W. Michael Blumenthal
Secretary of the Treasury
United States of America

credits and allowances between the related enterprises, to reflect any profits which would, but for those conditions, have accrued to one of the enterprises. The internal law of each Contracting State may also be applied to restrict the exemption of interest provided in paragraph 1 of Article 10 and of royalties provided in paragraph 1 of Article 11 to the amount of interest and royalties that would have been agreed upon between unrelated parties in cases where interest and royalties are paid by an enterprise of one Contracting State to a related enterprise in the other Contracting State.

4. It is agreed that each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the present Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto. This agreement shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security, or public policy.

I have the honor to propose to you that the present note and Your Excellency's reply thereto constitute the agreement of our two Governments on these points.

Accept, Excellency, the assurances of my highest consideration.

Sincerely yours,

Lajos Faluvegi
Minister of Finance
Hungarian People's Republic

THE SECRETARY OF THE TREASURY
WASHINGTON

February 12, 1979

Excellency:

I have the honor to refer to your letter of today's date concerning the Income Tax Convention signed today reading as follows:

In connection with the Income Tax Convention signed today, I should like to state our understanding of the agreement reached by the delegations of the United States of America and of the Hungarian People's Republic concerning the application of certain provisions of the Convention:

1. In connection with Article 9, subparagraph 5 c), it is understood that Hungary will not impose a tax in such cases.

2. Income (other than income from immovable property) will be taxed in accordance with the provisions of Article 7 and Article 13, rather than in accordance with the provisions of Article 19, if the person deriving the income, being a resident of one Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base.

3. In the case of dealings between an enterprise of one Contracting State and a related enterprise of the other Contracting State that involve conditions that differ from those that would have been made between independent

His Excellency
Lajos Faluvegi
Minister of Finance
Hungarian People's Republic

enterprises, each Contracting State may apply its internal law to distribute, apportion or allocate income, deductions, credits and allowances between the related enterprises, to reflect any profits which would, but for those conditions, have accrued to one of the enterprises. The internal law of each Contracting State may also be applied to restrict the exemption of interest provided in paragraph 1 of Article 10 and of royalties provided in paragraph 1 of Article 11 to the amount of interest and royalties that would have been agreed upon between unrelated parties in cases where interest and royalties are paid by an enterprise of one Contracting State to a related enterprise in the other Contracting State.

4. It is agreed that each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the present Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto. This agreement shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security or public policy.

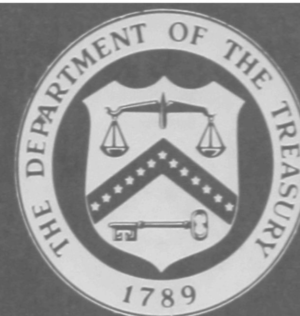
I wish to inform you that I agree with the contents of your letter.

Accept, Excellency, the assurance of my highest consideration.

Sincerely yours,

W. Michael Blumenthal

epartment of the TREASURY NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
February 9, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES WITHHOLDING OF APPRAISEMENT AND DETERMINATION OF SALES AT LESS THAN FAIR VALUE WITH RESPECT TO SUGAR FROM BELGIUM, FRANCE AND THE FEDERAL REPUBLIC OF GERMANY

The Treasury Department today said it has determined that sugar imported from Belgium, France, and the Federal Republic of Germany is being sold in the United States at "less than fair value." The case is being referred to the U. S. International Trade Commission, which must decide within 90 days whether a U. S. industry is being, or is likely to be, injured by these sales.

If the decision of the Commission is affirmative, dumping duties will be collected on sales found to be at less than fair value. (Sales at less than fair value generally take place when imported merchandise is sold in the United States for less than in the home market or to third countries.)

Under the Antidumping Act, the Secretary of the Treasury is required to withhold appraisement when he has reason to believe that sales at less than fair value are occurring. Withholding of appraisement means that the valuation of imported goods for Customs duty purposes is suspended. This is to permit the assessment of any dumping duties as appropriately determined on those imports.

Appraisement will be withheld for three months on imports of sugar from Belgium, France, and the Federal Republic of Germany, beginning on February 12, 1979.

The weighted-average margins of sales at less than fair value in these cases were 103 percent, 102 percent, and 121 percent for Belgium, France, and the Federal Republic of Germany, respectively.

Interested persons were offered the opportunity to present oral and written views before this determination.

Imports of sugar from the three countries during 1978 were valued at about $13 million.

Notice of this determination will appear in the Federal Register of February 12, 1979.

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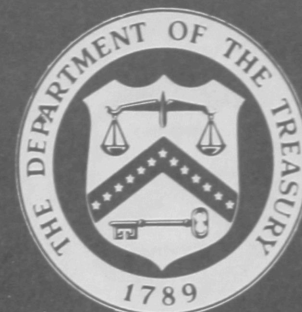

FOR IMMEDIATE RELEASE
February 12, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES SECOND DETERMINATION IN ANTIDUMPING INVESTIGATION BEGUN AS A RESULT OF STEEL TRIGGER PRICE MECHANISM

The Treasury Department today announced its final determination that exports of carbon steel plate from Taiwan produced by China Steel Corp. (China Steel) are being sold at "less than fair value" in the United States. The case is being referred to the U. S. International Trade Commission, which must decide within 90 days whether a U. S. industry is being, or is likely to be, injured by these sales.

Accordingly, appraisement of shipments will be withheld and bonds sufficient to cover potential dumping duties of 34 percent will be required of importers as of February 14, 1979. If the decision of the International Trade Commission is affirmative, dumping duties will be collected on sales found to be at less than fair value. (Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market or to third countries.)

This investigation is one of two pending "fast track" investogations begun on the basis of information collected through the Trigger Price Mechanism (TPM), created to monitor imports of steel mill products. A tentative determination with respect to the other investigation, involving carbon steel plate from Poland produced by Stahlexport Przedieriorstwoa, was published in the Federal Register on February 5, 1979. In that investigation the Treasury tentatively determined that sales at less than fair value were being made. A final determination in that case is due by May 5, 1979, although it is anticipated that such a determination will be made before then.

Both of these "fast track" investigations were initiated in October 1978 after evidence had been developed indicating that the companies were selling significant quantities of carbon steel plate to the United States at prices significantly less than the applicable trigger prices, and, accordingly to information developed in administering the TPM, apparently at less than fair value.

The investigation conducted to date indicates that sales of carbon steel plate from China Steel to the United States were made at less than fair value with margins as high as 38 percent.

The Antidumping Act requires the Secretary of the Treasury to withhold appraisement and obtain bonds to cover potential duties when he has reason to believe that sales at less than fair value are taking place. Withholding of appraisement means that valuation for Customs duty purposes of goods imported after the effective date of the determination is suspended until completion of the investigation. This is to permit assessment of any dumping duties that are ultimately imposed on those imports.

Interested parties were offered the opportunity to present oral and written views before this determination.

Notice of this action will appear in the Federal Register of February 14, 1979.

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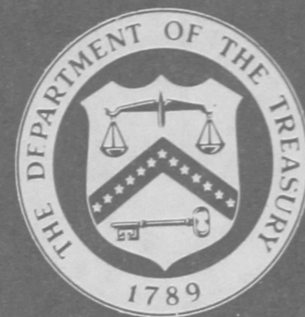

FOR IMMEDIATE RELEASE
February 12, 1979

Contact: Del Dobbins
202/566-5158

BLACK HISTORY MONTH EXHIBIT

U. S. Treasurer Azie Morton will open a Treasury Department exhibit featuring traditional African monetary systems at 12:45 today.

The exhibit is being sponsored by Treasury's Office of the Secretary in recognition of February as Black History Month.

"African Emblems of Wealth" features cloth, metal and shell currencies basic to traditional African trade and commerce. Items on display from East, West and Central Africa are on loan from the Museum of African Art in Washington.

Located in the north lobby of the main Treasury building, the exhibit will run through the month of February.

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B-1402

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

FOR IMMEDIATE RELEASE FEBRUARY 12, 1979

G. R. DICKERSON IS APPOINTED DIRECTOR
OF BUREAU OF ALCOHOL, TOBACCO AND FIREARMS

Secretary of the Treasury W. Michael Blumenthal today appointed G. R. Dickerson, Deputy Commissioner of U. S. Customs since 1974, as Director of the Bureau of Alcohol, Tobacco and Firearms, effective February 19.

Mr. Dickerson joined Customs in 1951 as a junior management assistant and since then has risen through the ranks.

Secretary Blumenthal said Mr. Dickerson's new appointment in ATF illustrates the success and flexibility of the Government's merit system of advancement, which enables a career professional to reach the highest levels of responsibility. Both Customs and ATF are agencies in the Treasury Department.

After service in the U. S. Army from 1945 to 1947, Mr. Dickerson earned a B. A. degree in government from Southern Methodist University, Dallas, Tex. He has also completed graduate courses in management at the American University in Washington, D. C.

After serving in increasingly responsible positions in Customs, he was promoted in 1964 to Deputy Director of the Division of Inspection and Control in the Office of Operations. In 1967 he was named Assistant Commissioner for Administration. He became Assistant Commissioner for Operations in 1972.

While Assistant Commissioner for Operations, Mr. Dickerson was instrumental in the development and expansion of a number of key programs, including the Tactical Interdiction Concept, the Treasury Enforcement Communications System (TECS), the Drug Detector Dog Program, major modernization programs to improve efficiency and service, and increased international activities such as expanded exchange and orientation programs with other Customs services.

Mr. Dickerson has participated extensively in the work of international organizations such as the International Civil Aviation Organization, the Intergovernmental Maritime Consultative Organization, the Organization of American States, the Economic Commission for Europe, and, in particular, the Customs Cooperation Council.

(MORE)

He received the Exceptional Service Award in October 1975, the U. S. Customs Honor Award in 1977, Treasury Department Superior Performance Awards in 1971 and 1973, and Special Act or Service Awards in 1965 and 1967.

Mr. Dickerson and his wife, Mary Elizabeth, live in McLean, Va.

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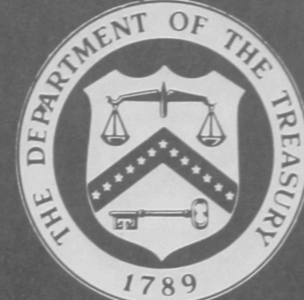

FOR IMMEDIATE RELEASE
FEBRUARY 13, 1979

Contact: Robert E. Nipp
202/566-5328

TREASURY ANNOUNCES DM NOTE SALE

The Department of the Treasury today announced that on Wednesday, February 21, 1979, it will offer notes denominated in Deutsche marks in an aggregate amount of approximately DM 2.5 billion. The notes will have maturities of two and one-half and three and one-half years and will be allocated between those maturities at the discretion of the Treasury.

The notes are being offered exclusively to, and may be owned only by, residents of the Federal Republic of Germany. The notes will be registered with the Bundesbank and may be transferred among German residents up to four times in amounts of DM 250,000 or multiples thereof.

The offering will be made exclusively in Germany through the Deutsche Bundesbank (German Central Bank) acting as agent on behalf of the United States. The notes will be offered at par, and the interest rates for both the two and one-half and three and one-half year notes will be announced on February 21, 1979. Subscriptions will be received by offices of the Bundesbank until 12:00 noon on February 22. For each maturity, subscriptions must be for amounts of DM 250,000 or multiples thereof. Payment for and issuance of the notes will be on March 1, 1979. They will not be listed, and it is not expected that the prices of the notes will be publicly quoted.

Under the Double Taxation Agreement between the Federal Republic of Germany and the United States of America, natural persons resident in the Federal Republic of Germany and German companies within the meaning of this Agreement are not subject to the withholding tax on interest income payable under U. S. law.

This offering represents the second DM- denominated borrowing pursuant to the joint Treasury and Federal Reserve Board announcement on November 1, 1978, concerning measures to strengthen the dollar.

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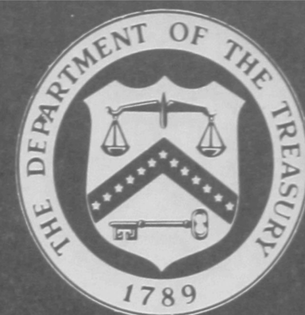
B-1404

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



FOR RELEASE AT 4:00 P.M. February 13, 1979

TREASURY TO AUCTION $2,480 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $2,480 million of 2-year notes to refund approximately the same amount of notes maturing February 28, 1979. The $2,477 million of maturing notes are those held by the public, including $388 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $368 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders. Additional amounts of the new securities may also be issued at the average price to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing securities held by them. This procedural change will not affect the amount of securities awarded to foreign and international monetary authorities, although, compared to the previous procedure, it could potentially reduce the amount of securities awarded competitively to private investors.

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

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B-1405

Attachment

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED FEBRUARY 28, 1979

February 13, 1979

<u>Amount Offered:</u>

To the public	$2,480 million

<u>Description of Security:</u>

Term and type of security	2-year notes
Series and CUSIP designation	Series Q-1981 (CUSIP No. 912827 JL 7)
Maturity date	February 28, 1981
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	August 31, 1979; February 29 and August 31, 1980; and February 28, 1981
Minimum denomination available	$5,000

<u>Terms of Sale:</u>

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

<u>Key Dates:</u>

Deadline for receipt of tenders	Wednesday, February 21, 1979, by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds	Wednesday, February 28, 1979
b) check drawn on bank within FRB district where submitted	Monday, February 26, 1979
c) check drawn on bank outside FRB district where submitted	Friday, February 23, 1979
Delivery date for coupon securities	Monday, March 5, 1979

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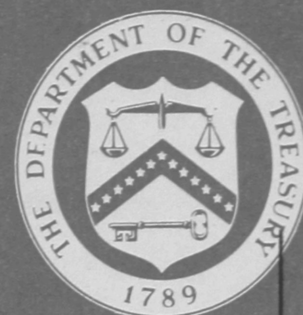

TRANSCRIPT OF NBC INTERVIEW WITH W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
ON TODAY SHOW
Thursday, February 15, 1979

TOM BROKAW: The New York Times is reporting this morning that Abu Dhabi is raising the price of oil by seven percent. Iranian production, of course, has been cut back completely. All this will have a big effect not only on American inflation, but also on the American life style. "Will we have to have rationed gasoline?," one of the many questions that no doubt will be asked this morning of Treasury Secretary Michael Blumenthal, who is standing by with Bob Abernethy in Washington.

BOB ABERNETHY: Good morning, Tom. Welcome, Secretary Blumenthal.

The other day Energy Secretary Schlesinger told Congress that because of the cut-off of oil from Iran, we face a situation prospectively more serious than the Arab oil embargo of '73-'74. Do you agree with that assessment?

SECRETARY OF THE TREASURY W. MICHAEL BLUMENTHAL: Well, it's perfectly true that we face a potentially serious situation. It's not critical, but it's a serious situation. And we have to pay a great deal of attention to it. A lot depends on what happens in Iran, what happens in other oil producing countries, and, importantly, what we do in our own country.

ABERNETHY: I want to get to that. Immediately after Secretary Schlesinger said what he did about the seriousness of the Iran cut-off, a lot of people around the world sold dollars and bought gold. Was it the situation that caused that run, or was it what Secretary Schlesinger said?

SECRETARY BLUMENTHAL: It's the situation that Secretary Schlesinger described that caused people to buy gold. That was about a day's flurry. Actually, the dollars' doing well.

ABERNETHY: There's a report today, as Tom said, that some of the OPEC countries are now going to take advantage of the Iran shutdown to boost up their prices even more than what had already been announced; another seven percent perhaps. Anything we can do about that?

SECRETARY BLUMENTHAL: Nothing we can do about it. When a product is in short supply, the people who are selling it raise the price. And that's bad. That's going to hurt all of the economies of the world.

ABERNETHY: The official administration estimate of the inflation rate this year has been 7.4%. Now oil prices are going up faster, I think, than had been anticipated. Last month wholesale prices were up 1.3% just for that month. Doesn't it now look as if prices for '79 will go up more than you'd expected?

SECRETARY BLUMENTHAL: I think really that's very difficult to tell in the month of February. When we're talking about 7.4%, we're predicting a comparison of the last quarter of this year to the last quarter of the previous year. We're going to have to wait.

Obviously rising oil prices make it more difficult to beat inflation. But we're making progress on other fronts a little better than we thought. So we have a chance.

ABERNETHY: One of your major jobs is to defend the value of the dollar around the world. If we face big increases in oil prices and if we face the possibility of shortages, wouldn't it make sense right now to do far more than we're doing to conserve?

SECRETARY BLUMENTHAL: It makes a lot of sense to do more than we're doing, than all of us are doing. The President referred to that in his press conference the other day. I think he's -- I wouldn't be at all surprised if he's going to talk about that and he's going to suggest some things in the future.

ABERNETHY: You know, a speech to the country, or something like that?

SECRETARY BLUMENTHAL: Well, I'm sure that he's going to have to talk about that more, yes.

ABERNETHY: But would you favor, for instance, a big new tax on gasoline?

SECRETARY BLUMENTHAL: I don't like to talk in terms of new taxes. I think the price of oil will go up for all kinds of reasons and should go up so that we conserve more. And there're many ways in which this can happen. And we're going to have to finish some studies and make some recommendations to the President before he can make up his mind what he wants to recommend.

ABERNETHY: But it's your feeling that the price should go up.

SECRETARY BLUMENTHAL: Oh, yes. I think it has to go up.

ABERNETHY: Secretary, Tom has a question in New York.

BROKAW: Mr. Secretary, under the present conditions, can you foresee avoiding gas rationing in this country, the shutdown in Iran and the consumption levels being what they are?

SECRETARY BLUMENTHAL: I think I can most certainly see avoiding rationing, because there're so many unknowns and there's so much we can do with conservation; there's so much we can do through a variety of measures in the private sector, as well as in the business sector, to save fuel. And also we don't know what the situation in Iran will be like. I don't really think that rationing is essential at all.

BROKAW: I want to ask you about the situation in Iran. Yesterday one of the Energy Department officials was saying that there had been some informal signals from Iran that they would be resuming production before the end of the year. But that's all very tentative, isn't it?

SECRETARY BLUMENTHAL: Oh, it's very tentative, because ths situation is confused at this point. Nobody knows exactly what is going to happen. But certainly for the economy of Iran to develop and to survive, some exporting will be necessary. And I'm sure that they will be exporting again when things settle down.

ABERNETHY: I want to change the subject, Mr. Secretary. Years ago you and your family escaped from Nazi Germany and went to China. You grew up, I think you've said, in the slums of Shanghai. Now you're the U. S. Secretary of the Treasury, and next week you become the first American official to go to Shanghai, to China since recognition. You're even going back to Shanghai, back to your old neighborhood.

How does that make you feel?

SECRETARY BLUMENTHAL: It makes me feel proud. It makes me feel excited; excited because we are going to have normal relations with a big and important country; proud to be representing

my country. And also excited about the prospects for helping President Carter establish that process for the benefit of people in both countries.

ABERNETHY: There's business to be done, of course. Are you convinced that the Chinese can pay for all they want to buy?

SECRETARY BLUMENTHAL: Well, they can't pay for all they want to buy. They're going to have to ration themselves and go slowly. I think they can pay for a lot, and it can increase from year to year. But it's not all going to happen in one or two years. They're going to have trouble paying for all of the goods that they really need.

ABERNETHY: Secretary Blumenthal, many thanks. Good luck on your trip.

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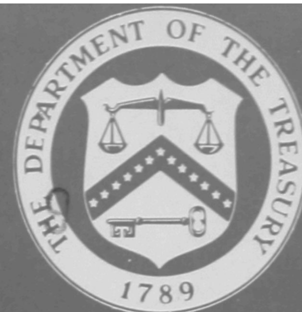

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FOR IMMEDIATE RELEASE
February 15, 1979

Contact: Alvin M. Hattal
(202)566-8381

TREASURY ANNOUNCES SECOND QUARTER 1979 TRIGGER PRICES

The Treasury Department today announced that the trigger price bases and extras that were in effect for the major steel mill products covered by the Trigger Price Mechanism (TPM) during the first quarter of 1979 will remain unchanged for the second quarter. TPM freight rates will increase by $1 and TPM handling on the West Coast will increase by $2. Second quarter trigger prices will apply to all shipments exported on or after April 1, 1979.

Trigger prices are based on the full cost of production of the world's most efficient group of steel producers, the Japanese steel companies. Each quarter the Treasury Department updates those estimated costs to reflect changes in these companies' cost of production. The TPM was designed to enable Treasury to discharge its responsibilities under the Antidumping Act rapidly and effectively.

The TPM includes a "flexibility band" of 5 percent to moderate price fluctuations, particularly those due to exchange rate changes. This band was used in establishing trigger prices for the first quarter of 1979 at 3 percent below Treasury's estimated total production costs which had increased by 10 percent because of yen appreciation. Trigger prices for the second quarter are 1.2 percent above Treasury's estimated total production costs. The amount over estimated total production costs results from restoration of 1.2 percent from the flexibility band.

The second quarter revision in the cost-of-production estimates are based on a 197 yen/dollar exchange rate (the average for the period December 11 through February 9); for the first quarter, a 187 rate (the average for the period September 4 through November 3) was used.

Second quarter cost estimates reflect information from a new and complete submission from Japan's Ministry of International Trade and Industry (MITI) on the costs of the six major integrated steel producers and the change in the yen/dollar exchange rate used.

The average cost of production per net ton of finished product is estimated to be $347.77, 3.9 percent lower than the first quarter cost estimate and 1.2 percent lower than the average first quarter trigger price level.

For products produced by the electric furnace companies, second quarter trigger prices will be decreased .7 percent or .8 percent, depending on the product. These prices reflect the yen depreciation and use of 1.2 percent of the flexibiility band. Treasury's estimate of the production costs of these producers decreased between 1.9 percent and 2.0 percent.

The Department is issuing appropriate revised pages for the TPM manual reflecting electric furnace cost changes.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

NOTICE

Imported Steel Mill Products Trigger Price Mechanism:
Second Quarter 1979 Revision of Trigger Prices

The Treasury Department hereby announces steel mill product trigger prices for the second quarter of 1979. These trigger prices are used by the Treasury Department to monitor the prices of steel mill product imports for the possible initiation of dumping investigations under the Antidumping Act. Each quarter Treasury reviews the cost of Japanese steel production and revises trigger prices as dictated by cost changes.

Second quarter trigger base prices and extras for steel mill products of the integrated steel producers, which account for 90 percent of U.S. steel mill imports, are unchanged from their first quarter levels.

The cost estimates for the second quarter, on which trigger prices are based, are calculated using a 197 yen/dollar exchange rate. The resulting decrease in Japanese steel production costs is accompanied by decreases in other cost factors and increases resulting from the decline in the five-year capacity utilization of the Japanese integrated producers.

The TPM included a "flexibility band" of 5 percent to moderate price fluctuations, particularly those due to exchange rate changes. This band was used in establishing trigger prices for the first quarter of 1979 at 3 percent below Treasury's estimated total production costs which had increased by 10 percent. 1.2 percent of the amount used in the last quarter is being restored.

The trigger prices of steel mill products of electric furnace producers will decrease .8 percent for Group A products, and .7 percent for Group B and Group C products. These prices reflect cost decreases of 2.0 percent and 1.9 percent, and the use of 1.2 percent of the flexibility band.

I. Integrated Producers

Treasury calculated the cost of producing steel in Japan for the second quarter trigger prices based on a 197 yen/dollar exchange ratio (the average rate between December 11, 1978, and February 9, 1979) and a recent cost submission by Japan's Ministry of International Trade and Industry (MITI). This submission updates the complete cost information on the six major Japanese steel producers provided by MITI in late 1977 and early 1978 for the original TPM cost calculations.

Treasury has reviewed the MITI submission and has conducted in-depth discussions with MITI representatives to probe the cost submission and obtain additional data. The MITI data was further verified through comparison, where possible, with published information including the financial statements of the six major Japanese steel firms for the first half of their 1978 fiscal year, April through September 1978, and other information available to the Department.

Table 1 below shows the resulting average cost per ton of finished product for integrated producers.

Table 1: Japanese Costs of Production Estimates: Integrated Steel Producers

(U.S. dollars per ton of finished product)

	First Quarter 1979	Second Quarter 1979
Basic Raw Materials	$ 116.20	$ 119.03
Other Raw Materials	81.70	72.21
Labor	97.75	94.07
Other Expenses	33.99	28.65
Depreciation	27.58	29.72
Interest	27.34	25.96
Profit*/	26.37	25.12
Yield Credit	(11.34)	(10.82)
Total Cost per MT	$ 399.59	$ 383.94
Total Cost per NT	$ 362.51	$ 348.31

*/Profit=.08 (Raw materials + labor + other expenses)

The $14 decrease in cost per net ton from costs used to establish first quarter trigger prices reflects several changes in cost components, the largest being the depreciation of the yen relative to the dollar from 187 yen/dollar during the two-month time period used for the first quarter cost calculation (the average for September 4 through November 3) to 197 yen/dollar during the period used for the second quarter calculation. Alone, the yen depreciation accounted for about a $13 decrease in the cost estimates.

This decrease was partially offset by a decrease in the capacity utilization average resulting from a roll-over of the five-year capacity utilization average. The five-year period now covers 1974-1978; thus 1978, a year of low utilization for the six integrated producers, replaced 1973, a year of high utilization, in the calculation of the average. This caused a decrease of approximately five percentage points in the five-year capacity utilization average and almost a $7 increase in the cost estimate.

Continued conversion to continuous casting allowed the Japanese industry to improve its ingot-to-product yield; this improvement produces about a $4 decrease in Japanese steel production costs. Treasury analysts consider a portion of the yield rates reported by MITI to represent the production of secondary material; hence, instead of the 87.5 percent yield rate reported by MITI, Treasury utilized 83.7 percent. The difference between those two figures is treated as secondary quality material and valued as such in the cost calculations (yield credit).

Changes in the cost of materials and capital -- some increases and some decreases -- resulted in a net cost saving of about $4. This net saving is the result of cost-cutting measures taken by the integrated producers as well as bargaining with their suppliers. Most of the increase in labor costs during 1978 was accounted for in Treasury's third quarter 1978 TPM cost estimate, following the integrated producers' Spring negotiations with their work force.

II. Electric Furnace Producers

Japan's electric furnace steel producers have no uniform fiscal year; hence, MITI was unable to provide a similar fresh data submission for these producers as a whole. However, Treasury adjusted its estimates of electric furnace production costs to reflect the depreciation of the yen. Table 2 shows the second quarter TPM estimates of electric furnace production costs.

A careful review of other cost components with particular attention paid to the cost of scrap, which accounts for nearly 50 percent of the production costs of electric furnace products, indicated that no other change is required in our cost estimates. A scrap cost increase was shown in the third quarter of 1978 and a raise negotiated in labor wages was shown in the fourth quarter.

TABLE 2

Japanese Production Costs: Electric Furnace Products

(U.S. dollars per metric ton of finished product)

	Group A[1]		Group B[2]		Group C[3]	
	1st Qtr. 1979	2nd Qtr. 1979	1st Qtr. 1979	2nd Qtr. 1979	1st Qtr. 1979	2nd Qtr. 1979
Basic Raw Materials	$165.76	$157.81	$178.22	$169.92	$164.30	$156.74
Other Raw Materials	35.76	34.76	42.24	41.08	38.61	37.55
Labor	32.43	30.80	36.92	35.05	25.85	24.56
Other Expenses	12.91	12.25	15.76	14.96	16.27	15.45
Depreciation	7.02	6.67	8.93	8.48	7.19	6.82
Interest	7.89	7.47	11.27	10.69	7.23	6.86
Profit[4]	19.75	18.85	21.85	20.88	19.60	18.74
Scrap Credit	(2.98)	(2.83)	(3.36)	(3.19)	(2.94)	(2.79)
Total $/MT	$278.54	$265.78	$311.83	$297.87	$276.11	$263.93
Total $/NT	$252.69	$241.11	$282.89	$270.23	$250.48	$239.44

1/ Group A products are equal angles, unequal angels, channels, and I-beams.

2/ Group B products are hot rolled strip from bar mills; merchant quality hot bars; hot rolled round bars, squares, and round cornered squares; and bar size channels.

3/ Group C products are concrete reinforcing bars, plain and deformed.

4/ Profit=.08 (Raw materials + labor + other expenses)

III. Other Factors

At Treasury's request, MITI also submitted an update of the freight and handling costs of shipping steel from Japan to the United States. TPM freight rates will uniformly increase $1 for the second quarter, and the West Coast handling charge will increase by $2.

IV. Revision Schedule

MITI requested that trigger prices be revised only semi-annually instead of quarterly as is Treasury's current practice. Treasury does not feel that a change in methodology is warranted at this time.

V. Replacement Pages

Replacement pages hereby issued for electric furnace products follow.

General Counsel

Date: FEB 15 1979

Rev. Feb. 1979

STANDARD CARBON STEEL CHANNELS, ASTM A36

Category AISI 3,9

Tariff Schedule Number (s)		
	609.8041	0.1¢/lb.
	609.8070	0.1¢/lb.

Base Price per Metric Ton	1st Qtr.	2nd Qtr.
	$276	$274

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$4
Gulf Coast	$27	5	5
Atlantic Coast	$30	4	5
Great Lakes	$36	4	7

Insurance 1% of base price + extras +ocean freight

Extras

Size Extra

Rev. Feb. 1979

SIZE EXTRAS
($/MT)

SIZE	1st Quarter	2nd Quarter
C1	13	13
C3	Base	Base
C4	Base	Base
C6	13	13
C8	20	20
C10	20	20
C12	26	26
C15	26	26

Rev. Feb. 1979

UNEQUAL LEG CARBON STEEL ANGLES ASTM A-36

Category AISI 3,9

Tariff Schedule Number (s)		
	609.8035	0.1¢/lb.
	609.8050	0.1¢/lb.

Base Price per Metric Ton	1st Quarter	2nd Quarter
	$290	$288

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$4
Gulf Coast	$27	5	5
Atlantic Coast	$30	4	5
Great Lakes	$36	4	7

Insurance 1% of base price + extras +ocean freight

Extras

Size Extra

Rev. Feb. 1979

SIZE EXTRAS
($/MT)

SIZE	1st Quarter	2nd Quarter
3" x 3"	13	13
3-1/2" x3"	13	13
4" x 3"	Base	Base
5" x 3"	Base	Base
6" x 3-1/2"	13	13
6" x 4"	13	13
8" x 4"	13	13

EQUAL LEG CARBON STEEL ANGLES ASTM A36

Category AISI 3,9

Tariff Schedule Number (s)		
	609.8035	0.1¢/lb.
	609.8050	0.1¢/lb.

Base Price per Metric Ton	1st Quarter	2nd Quarter
	$261	$259

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$4
Gulf Coast	$27	5	5
Atlantic Coast	$30	4	5
Great Lakes	$36	4	6

Insurance 1% of base price + extras + ocean freight

Extras

Size Extra

Rev. Feb. 1979

SIZE EXTRAS
($/MT)

SIZE	1st Quarter	2nd Quarter
1" x 1"	20	20
1-1/2" x 1-1/2"	9	9
2" x 2"	Base	Base
3" x 3"	Base	Base
4" x 4"	Base	Base
5" x 5"	20	20
6" x 6"	32	32
8" x 8"	32	32

Rev. Feb. 1979

STANDARD CARBON STEEL "I" BEAMS ASTM A36

Category AISI 3,9

Tariff Schedule Number (s)	609.8045	0.1¢/lb.
	609.8090	0.1¢/lb.

Base Price per Metric Ton	1st Quarter	2nd Quarter
	$318	$315

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$4
Gulf Coast	$27	5	6
Atlantic Coast	$30	5	6
Great Lakes	$36	4	7

Insurance 1% of base price + extras + ocean freight

Extras

1. Size Extra

SIZE EXTRAS
($/MT)

SIZE	1st Quarter	2nd Quarter
S12 x 31.8 lb./ft	Base	Base
S8 X 18.4 lb./ft	Base	Base
S6 x 12.5 lb./ft	13	13
S4 x 7.7 lb./ft	13	13

SIZE EXTRAS JUNIOR BEAMS

M-12" x 11.8 lb./ft	Base	Base
M-10" x 8.0 lb./ft	Base	Base
M-8" x 6.5 lb./ft	13	13
M-6" x 4.4 lb./ft	35	35

Rev. Feb. 1979

PLAIN AND DEFORMED CARBON STEEL CONCRETE REINFORCING BARS ASTM A615

Category AISI 8

Tariff Schedule Number (s) 608.4000 7 1/2%
608.4100 7 1/2%

Base Price per Metric Ton	1st Quarter	2nd Quarter
	$257	$255

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$4
Gulf Coast	$27	5	5
Atlantic Coast	$30	4	5
Great Lakes	$36	4	6

Insurance 1% of base price + extras + ocean freight

Extras

1. Size Extras
2. Grade Extras

SIZE AND GRADE EXTRAS
($/MT)

	1st Quarter Extra	2nd Quarter Extra
GRADE 40		
#3	16	16
#4	9	9
#5 THROUGH #10	Base	Base
#11 THROUGH #12	16	16
GRADE 60		
#3	32	32
#4	26	26
#5 THROUGH #10	18	18
#11 THROUGH #12	32	32

HOT ROLLED CARBON STEEL BAR SIZE CHANNEL ASTM A36

Category AISI 9

Tariff Schedule Number (s) 608.8070 - 0.1¢ per lb.

	1st Quarter	2nd Quarter
Base Price per Metric Ton	$384	$381

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$6
Gulf Coast	27	5	7
Atlantic Coast	30	4	7
Great Lakes	36	4	9

Insurance 1% of base price + extras + ocean freight

Extras

1. Size Extras

SIZE EXTRA
($/MT)

SIZE	1st Quarter EXTRA	2nd Quarter EXTRA
1" x 1/2" x 1/8"	66	66
1-1/4" x 1/2" x 1/8"	40	40
1-1/2" x 1/2" x 1/8"	40	40
2" x 1" x 1/8"	13	13
2" x 1" x 3/16"	BASE	BASE

MERCHANT QUALITY HOT ROLLED CARBON STEEL SQUARES AND ROUND CORNERED SQUARES ASTM A 36 or AISI 1020

Category AISI 10

Tariff Schedule Number (s) 608.4660-7%

	1st Quarter	2nd Quarter
Base Price per Metric Ton	$320	$318

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$5
Gulf Coast	27	5	6
Atlantic Coast	30	4	6
Great Lakes	36	4	8

Insurance 1% of base price + extras + ocean freight

Extras

1. Size Extra

SIZE EXTRAS
($/MT)

	1ST Quarter	2nd Quarter
SIZE	EXTRA	EXTRA
3/8"	40	40
7/16"	26	26
1/2"	20	20
5/8"	7	7
3/4" to 1-3/4"	BASE	BASE
2"	14	14
2-1/4" to 3"	26	26

MERCHANT QUALITY HOT ROLLED CARBON STEEL ROUND BAR ASTM A36 or AISI 1020

Category AISI 10

Tariff Schedule Number (s) 608.4540-7%

	1st Quarter	2nd Quarter
Base Price per Metric Ton	$320	$318

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$5
Gulf Coast	27	5	6
Atlantic Coast	30	4	6
Great Lakes	36	4	8

Insurance 1% of base price + extras + ocean freight

Extras

1. Size Extra

SIZE EXTRA
($/MT)

	1st Quarter	2nd Quarter
DIAMETER	EXTRA	EXTRA
7/16"	40	40
1/2"	13	13
5/8" to 1"	BASE	BASE
1-1/3" to 2"	13	13
2-1/4" to 3"	24	24

MERCHANT QUALITY CARBON STEEL FLAT BARS ASTM A36 OR AISI 1020

Category AISI 10

Tariff Schedule Number (s) 608.4620-7%

	1st Quarter	2nd Quarter
Base Price per Metric Ton	$291	$289

Charges to CIF	Ocean Freight	Handling	Interest
West Coast	$24	$9	$4
Gulf Coast	27	5	6
Atlantic Coast	30	4	6
Great Lakes	36	4	7

Insurance 1% of base price + extras + ocean freight

Extras

1. Size Extra

SIZE EXTRA

1st and 2nd Quarters

(1) Flat Bar (U.S. $ per Metric Ton)

Width/ Thickness	1/2"	5/8"	3/4"	1"	1 1/4"	1 1/2"	1-3/4"	2"	2 1/2"	3"	3 1/2"	4"	5"	6"	7" 8"
3/16"	53	39	33	20	16	16	16	16	16	*	*	*	*	*	*
1/4"	46	33	26	13	6	6	6	B	B	B	B	B	B	13	*
3/8"	*	*	26	13	6	6	6	B	B	B	B	B	B	B	16
1/2"	*	*	*	13	6	6	6	B	B	B	B	B	B	B	16
5/8"	*	*	*	26	13	13	13	6	6	6	6	6	6	6	16
3/4"	*	*	*	26	13	13	13	6	6	6	6	6	6	6	16
7/8"	*	*	*	*	*	*	*	6	6	6	6	6	6	6	16
1"	*	*	*	*	26	26	26	6	6	6	6	6	6	6	16
1 1/8"	*	*	*	*	*	*	*	*	*	10	10	10	10	10	21
1 1/4"	*	*	*	*	*	*	*	*	*	16	16	16	16	16	26
1 1/2"	*	*	*	*	*	*	*	*	*	21	21	21	21	21	31

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FOR IMMEDIATE RELEASE
February 15, 1979

Contact: Alvin M. Hattal
566-8381

TREASURY DEPARTMENT WITHHOLDS APPRAISEMENT OF
CONDENSER PAPER FROM FRANCE AND FINLAND

The Treasury Department today said it is withholding appraisement on imports of condenser paper from France and Finland based on a tentative determination that they are being sold in the United States at less than fair value. The withholding of appraisement will not exceed six months. A final determination will be issued in three months.

Under the Antidumping Act, the Secretary of the Treasury is required to withhold appraisement when he has reason to believe or suspect that sales at "less than fair value" are taking place. (Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market or to third countries.)

Withholding of appraisement means that the valuation for Customs duty purposes of goods imported after the date of the tentative determination is suspended until completion of the investigation. This is to permit any assessment of dumping duties that are ultimately imposed on those imports.

Cases in which a final determination of sales at less than fair value is issued are referred to the U.S. International Trade Commission to determine whether an American industry is being or likely to be injured by such sales. Both sales at less than fair value and injury must be found to exist before a dumping finding is reached.

Notice of this action will appear in the Federal Register of February 20, 1979.

Imports of condenser paper from France during January-October 1978 were valued at about $1.7 million. Imports from Finland in the period February-July 1978 were valued at about $528,000.

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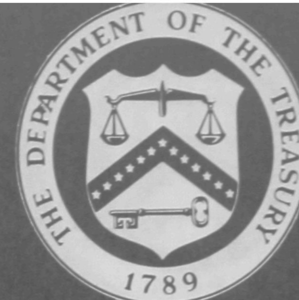


FOR IMMEDIATE RELEASE
February 15, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES PRELIMINARY COUNTERVAILING DUTY ACTION ON GRAIN-ORIENTED SILICON STEEL FROM ITALY

The Treasury today announced its preliminary determination that the Government of Italy is not subsidizing exports to the United States of grain-oriented silicon steel.

This investigation was begun after information was received on behalf of the American industry. A final decision in this case will be made as soon as interested parties have an opportunity to comment on the preliminary determination.

Treasury's preliminary investigation found that the product is produced by Terni, a subsidiary of the Finsider group of Italian steel companies. Although Italian government funds have been committed to increase the capital of Finsider, there is no evidence that these funds benefited Terni or the production or export of grain-oriented silicon steel.

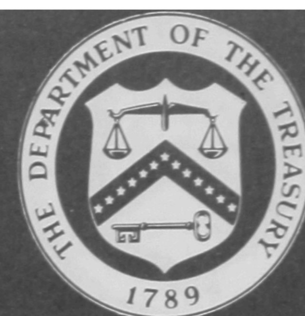
Notice of this action appeared in the Federal Register of February 14, 1979.

Imports of this merchandise from Italy during the second half of 1978 were valued at about $4 million.

* * *

B-1408

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



FOR IMMEDIATE RELEASE
February 16, 1979

Contact: Alvin M. Hattal
566-8381

TREASURY ANNOUNCES FINAL DETERMINATION IN COUNTERVAILING DUTY INVESTIGATION OF PAPERMAKING MACHINES AND PARTS FROM FINLAND

The Treasury Department today announced a final determination that imported papermaking machinery and parts thereof from Finland are not being subsidized.

The Countervailing Duty Law requires the Secretary of the Treasury to collect an additional duty equal to the subsidy on merchandise exported to the United States.

Treasury's investigation found that one Finnish manufacturer of this merchandise received benefits in the form of preferential interest rates on commercial loans as a result of guarantees supplied by the Government of Finland, but that these benefits were less than 0.02 percent ad valorem. Such benefits are considered de minimis in size, or too inconsequential to justify consideration as a subsidy.

Notice of this action will appear in the Federal Register of February 20, 1979.

Imports of this merchandise from Finland during the first 10 months of 1978 were valued at about $4-million.

B-1409

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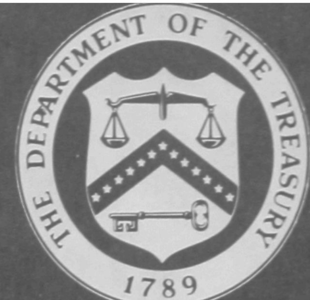
WASHINGTON, D.C. 20220 TELEPHONE 566-2041



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TREASURY DEPARTMENT

FOR IMMEDIATE RELEASE
February 16, 1979

Contact: Robert Nipp
202/566-5328

Secretary Blumenthal to Visit People's Republic of China and Japan

Secretary of the Treasury W. Michael Blumenthal will lead a U.S. delegation to the People's Republic of China to discuss bilateral issues including trade relations and economic cooperation.

The Secretary and his party depart Washington for Peking on Friday, February 23, returning Monday, March 5.

In Peking, the Secretary will meet with high level PRC officials to discuss the settlement of frozen private claims, trade relations and other issues that must be addressed to permit normalization of economic and commercial relations. Brief discussions on these topics were initiated during the visit of Vice Premier Deng to Washington in January.

Working sessions will be held on the requirements for a trade agreement; the banking and investment mechanisms of each country; and the tax treatment of foreign firms operating in China. Secretary Blumenthal will also participate in the ceremonies marking the opening of the U.S. Embassy in Peking on March 1.

Following his visit to Peking the Secretary will visit Shanghai, where he will visit factories and other commercial enterprises. Secretary Blumenthal will depart China on March 4 for Tokyo where he will meet with government officials. He will brief Japanese officials on his visit to China and discuss with them the global economic and monetary outlook as well as bilateral matters of mutual interest.

Attached is a list of the delegation travelling with the Secretary.

(over)

SECRETARY BLUMENTHAL'S DELEGATION

Members of Official Delegation

W. Michael Blumenthal, Secretary of the Treasury

Mrs. Blumenthal

Anthony M. Solomon, Under Secretary of the Treasury for Monetary Affairs

Robert Mundheim, General Counsel of the Treasury

Julius Katz, Assistant Secretary of State

Joseph Laitin, Assistant Secretary of the Treasury for Public Affairs

Michael Oksenberg, National Security Council

Richard W. Fisher, Executive Assistant to the Secretary of the Treasury

Scott Hallford, Special Assistant to the Secretary of the Treasury

Russell Munk, Assistant General Counsel of the Treasury

Mark B. Feldman, Deputy Legal Advisor, Department of State

Emil Sunley, Deputy Assistant Secretary for Tax Policy, Department of the Treasury

Stanley Marcus, Deputy Assistant Secretary of Commerce

John Renner, Office of the Special Trade Representative

Patricia Haas, International Economist, Office of East-West Trade, Department of the Treasury

Stan Shapiro, Assistant Director for General Services, Department of the Treasury

Elizabeth Astudillo, Secretary to the Secretary of the Treasury

Janice Johnson, Delegation Secretary

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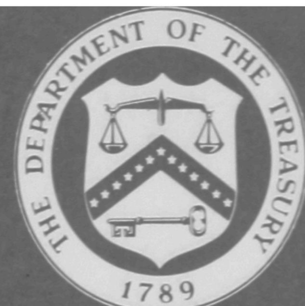

FOR IMMEDIATE RELEASE February 16, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,000 million of 13-week Treasury bills and for $3,002 million of 26-week Treasury bills, both series to be issued on February 22, 1979, 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 24, 1979			26-week bills maturing August 23, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.660	9.257%	9.61%	95.270	9.356%	9.96%
Low	97.646	9.313%	9.67%	95.258	9.380%	9.98%
Average	97.651	9.293%	9.65%	95.263	9.370%	9.97%

Tenders at the low price for the 13-week bills were allotted 71%.
Tenders at the low price for the 26-week bills were allotted 89%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 39,425,000	$ 39,425,000	$ 21,925,000	$ 21,925,000
New York	4,832,965,000	2,560,565,000	4,957,565,000	2,740,700,000
Philadelphia	22,115,000	22,115,000	7,725,000	7,725,000
Cleveland	98,830,000	23,830,000	20,845,000	14,845,000
Richmond	34,695,000	34,695,000	15,145,000	12,145,000
Atlanta	29,025,000	29,025,000	19,750,000	19,750,000
Chicago	205,255,000	67,355,000	183,810,000	18,810,000
St. Louis	43,980,000	18,980,000	43,080,000	11,080,000
Minneapolis	12,935,000	12,935,000	11,910,000	11,910,000
Kansas City	20,625,000	20,625,000	29,765,000	20,155,000
Dallas	10,180,000	10,180,000	5,160,000	5,160,000
San Francisco	211,830,000	149,830,000	265,385,000	105,385,000
Treasury	10,755,000	10,755,000	12,070,000	12,070,000
TOTALS	$5,572,615,000	$3,000,315,000a/	$5,594,135,000	$3,001,660,000b/

/Includes $387,470,000 noncompetitive tenders from the public.
/Includes $204,055,000 noncompetitive tenders from the public.
/Equivalent coupon-issue yield.

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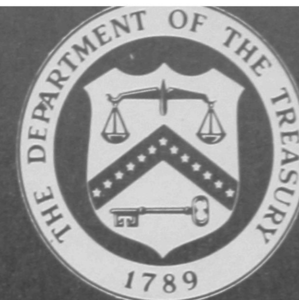

FOR RELEASE AT 4:00 P.M. February 22, 1979

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $3,320 million, of 364-day Treasury bills to be dated March 6, 1979, and to mature March 4, 1980 (CUSIP No. 912793 3E 4). This issue will not provide new cash for the Treasury as the maturing issue is outstanding in the amount of $3,321 million.

The bills will be issued for cash and in exchange for Treasury bills maturing March 6, 1979. The public holds $1,471 million of the maturing issue and $1,850 million is held by Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average price of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents of foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

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. This series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, 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 28, 1979. 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.

B-1412

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders 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 on all accepted tenders 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. 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. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action 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 weighted average price (in three decimals) of accepted competitive bids.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on March 6, 1979, in cash or other immediately available funds or in Treasury bills maturing March 6, 1979. 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 these bills 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 these bills (other than life insurance companies) must include in his or her 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 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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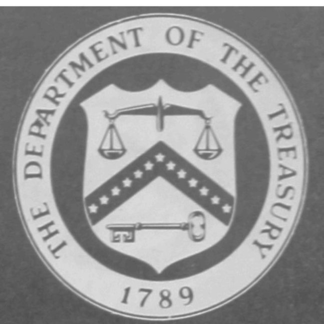

FOR RELEASE AT 11:30 A.M. February 21, 1979

TREASURY TO AUCTION $2,500 MILLION OF 4-YEAR 1-MONTH NOTES

The Department of the Treasury will auction $2,500 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 competitive tenders.

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

oOo

Attachment

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 4-YEAR 1-MONTH NOTES
TO BE ISSUED MARCH 5, 1979

February 21, 1979

Amount Offered:

To the public........................	$2,500 million

Description of Security:

Term and type of security...........	4-year 1-month notes
Series and CUSIP designation........	Series D-1983 (CUSIP No. 912827 JM 5)
Maturity date........................	March 31, 1983
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...............	September 30 and March 31 (first payment on September 30, 1979)
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.....	Tuesday, February 27, 1979, by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds.......	Monday, March 5, 1979
b) check drawn on bank within FRB district where submitted....................	Friday, March 2, 1979
c) check drawn on bank outside FRB district where submitted....................	Friday, March 2, 1979
Delivery date for coupon securities.	Friday, March 9, 1979

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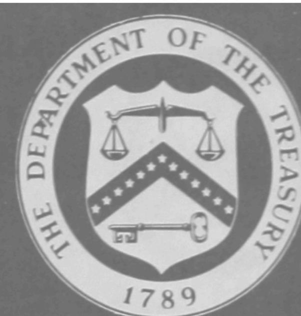

FOR IMMEDIATE RELEASE February 21, 1979

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $2,482 million of $4,604 million of tenders received from the public for the 2-year notes, Series Q-1981, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.75% 1/
Highest yield	9.87%
Average yield	9.85%

The interest rate on the notes will be 9-3/4%. At the 9-3/4% rate, the above yields result in the following prices:

Low-yield price	100.000
High-yield price	99.787
Average-yield price	99.822

The $2,482 million of accepted tenders includes $ 488 million of noncompetitive tenders and $1,584 million of competitive tenders from private investors, including 87% of the amount of notes bid for at the high yield. It also includes $410 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 to the $2,482 million of tenders accepted in the auction process, $368 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, 1979.

1/ Excepting 3 tenders totaling $30,000

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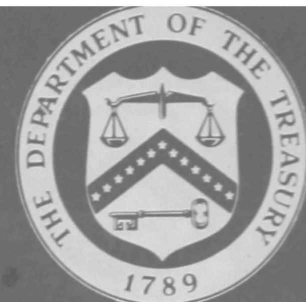

FOR IMMEDIATE RELEASE
February 21, 1979

Contact: Robert E. Nipp
202/566-5328

TREASURY ANNOUNCES INTEREST RATES ON DM NOTES

The Department of the Treasury today announced that the interest rates on its two and one-half year and three and one-half year notes denominated in DM are 6.30 percent and 6.70 percent, respectively. The notes are priced at par. Interest shall be paid annually.

As announced earlier, the Treasury is offering notes denominated in DM in an aggregate amount of approximately DM 2.5 billion. The notes are being offered exclusively to, and may be owned only by, residents of the Federal Republic of Germany. Subscriptions will be received by the German Bundesbank, acting as agent on behalf of the United States, until 12:00 noon, Frankfurt time, on Thursday, February 22, 1979.

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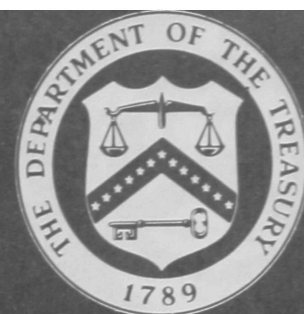

FOR IMMEDIATE RELEASE
February 21, 1979

The U.S. Treasury monthly gold sale in Washington, D.C. which had been delayed from February 20 because of snow emergency conditions, is now rescheduled for Thursday, February 22, at 11:00 a.m., EST.

The amounts to be sold and the terms and conditions of the Invitation for Bid remain the same, except that final payment will be due on March 5 and delivery must be taken by March 19.

# # #

B-1416

Department of the TREASURY NEWS

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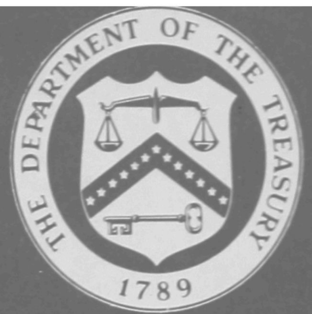


FOR RELEASE ON DELIVERY
Expected 10:00 AM
Saturday, February 24, 1979

REMARKS OF
PETER D. EHRENHAFT
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR TARIFF AFFAIRS
AT THE HARVARD UNIVERSITY INTERNATIONAL LAW
JOURNAL TWENTIETH ANNIVERSARY SYMPOSIUM ON MULTINATIONAL
CORPORATIONS. Cambridge, Massachusetts

Multinational Enterprises and the Antidumping Law

Those of us working actively in the realm of International Trade are fond of referring to the GATT and our current set of trade regulatory institutions as the "rules of the game." In this symposium we have already heard how the growth of multinational enterprises (MNE's) has not only changed "the rules of the game," but even the way in which we identify the players. Firms that were formerly thought of and called themselves "American" now take a global view: one that can be at once both more Olympian and more irresponsible than that of the government with which they identify. With the ability and willingness to draw upon the world at large for the cheapest inputs and the best markets, MNE's are in large part responsible for the dramatic shift in the U.S. trade balance over the last two decades. They are at once among those most frequently invoking our laws aimed at unfair trade practices and the principal respondents in our growing caseload. In some proceedings, the question has been raised whether one part of an MNE selling from abroad can, within the meaning of the law, be injuring another.

Before discussing in greater detail how the growth of MNE's has affected that corner of U.S. trade policy with which I am most concerned at Treasury, a few broad brush settings of the subject seem in order. Our notions of dumping have matured in the 21 years since I first wrote about them in the Columbia Law Review. Principally we have come increasingly to recognize the importance of the Antidumping Act (and its cousin, the countervailing duty law), as the interfaces between competing economies. The number of economies actively participating in world trade has increased; their demands for recognition of appropriate internal goals of development have become more vocal -- and listened to. And, paradoxically, as the national governmental actors have increased in number and advocacy, the most important private participants in world trade -- the MNE's -- have loosened their national identification. This is the natural consequence of such facts as:

-- An MNE may be owned or managed by nationals of countries other than the one in which its component of immediate interest is operating;

-- The government of each country with a significant nexus to the MNE may and does claim rights and obligations affecting the MNE's operation. The application of the U.S. Export Administration Act to the production in a foreign country and sale of goods to third countries by a component of an MNE that derives technology from its related U.S.

sources, is perhaps the best illustration of the problem;

-- MNE's are able to produce, assemble, sell and service goods from multiple sources, achieving comparative advantages in their ultimate ability to make and sell products that are denied to concerns limited to a single jurisdiction;

-- MNE's need, use, acquire and sell a variety of currencies in their operations. Even if they wanted to, they could not effectively deal in a single unit of account. Their management of multiple currency portfolios contributes meaningfully to the instability of worldwide exchange rates.

Against this background stands the Antidumping Act, a small, but important, feature of the trade terrain. The grand patriarch of dumping law and lore, Jacob Viner, called dumping "a problem in international trade," first recognized as such about a century ago. The development of legal norms to cope with the problem paralleled efforts to deal with similar phenomena emerging in the large domestic, continental-size market of the United States. The notion in each situation was that the free market required protection from the predatory pricer: from the producer who sold in the "target" market at

a price lower than what he, himself, established as his normal or "fair" price in his "usual" market, to the detriment of competing, local suppliers in the target area. The assumption was that the local suppliers would eventually be driven out of business, whereafter the alien would increase his prices. The bargain available during the period of dumping was -- is -- regarded as too transitory to compensate for the local disruption and possible long term higher pricing presumed to follow the foreigner's capture of the market.

In its international ramifications, the law assumes the existence of separate "home" or "third" country and "domestic" markets in which price levels can be independently determined by the supplier. The assumptions are probably valid in many cases; the necessary isolation of markets does occur; the freedom to set prices exists. But in an increasingly interdependent world, with ever-reduced tariff barriers, with faster and cheaper transport, with the homogenization of world taste, the model often does not fit. Particularly in the case of trade involving MNE's, the separate character of the two relevant markets may be wholly blurred. The whole world is their market.

The price comparability exercise critical to a determination of "dumping" is also more difficult to perform. The intra-corporate transfer prices between related parties may not reflect arms'-length dealings. Our Antidumping Act in fact presumes they do not, requiring us to undertake an elaborate

investigation and computation based on the first sale by the MNE's U.S. seller to an <u>unrelated</u> party, and then to work back through the related company's costs to a foreign export price that is then compared to the home market price (or other appropriate comparison point) of the foreign producer.

Even that was not regarded as sufficiently reliable in the case of the big MNE's by the drafters of the Trade Act of 1974. They added to the Antidumping Act a new §205(d). It provides that if an MNE has production and sale facilities in 2 or more foreign countries, only one of which is supplying the U.S. market, the home market prices of the entity actually supplying the U.S. are to be disregarded if the second (or third or fifth) related entity supplying non-U.S. markets is selling the same goods in those markets at higher prices than those at which the merchandise is sold to the U.S. by the first. The notion was that MNE's may use related company what the Senate Finance Committee characterized as "subsidization" to offset unfairly low prices to the U.S. It is an interesting notion. However, to date it has never been invoked. On the other hand, a number of other related party problems have emerged. They illustrate the problem of applying the Antidumping Act to multinational enterprises. They deserve study and perhaps some new thoughts:

(1) Related selling agents. Section 204 of the Act defining "exporter's sales price," dates from 1921. It was the first-- and for many years the only -- recognition that MNE's pose special problems for an antidumping law. As already noted, it presumes the impropriety of using actual transaction prices in a sale by a foreign producer to its U.S. selling agent for resale. It requires a determination of the U.S. resale prices, from which there are deducted the U.S. seller's costs in bringing the merchandise to the U.S. and to the point of sale. The determination of such costs can be a time-consuming exercise. It is made particularly difficult when the goods are not immediately resold upon importation but are either held in inventory or are further processed. If the goods are fungible, inventory flows are hard to monitor; if the goods are elaborately worked before resale, the cost calculations are likely to be inordinately complex (e.g., imported steel sheet eventually resold in the form of railroad cars). Moreover, to ascertain resale and cost data may involve significant time lags. The lapse between the U.S. resale and the date at which the original goods were exported -- which, under our regulations, §153.57, is the relevant date for making the comparison with the foreign market value of the goods -- takes no account of intervening market or currency changes.

A further wrinkle to these provisions, which has caused significant comment in connection with our so-called Trigger Price Mechanism for imported steel mill products (with which I

assure you are all familiar) derives from the fact that in subtracting the U.S. related party's selling expenses from its resale prices, in order to reach the figure we compare with the foreign sales price, no allowance is required for profits. As a result, the related party seller is claimed to have an advantage over unrelated sales agencies who must naturally earn a profit to survive. On the other hand, since selling expenses in the U.S. must be deducted in our calculations to reach the price to be compared abroad, we also deduct selling costs incurred in the home market to compute the comparable foreign market value. But the deduction abroad is limited by our regulations, §153.10(b), to the expenses incurred on the U.S. side. It is an arbitrary rule but one considered necessary to put some reasonable cap on the volume of detailed data we are required to evaluate and verify, particularly as differences in selling expenses between the two markets are generally not viewed as proper adjustments to the prices being compared.

(2) Related buying agents. The Act has long dealt with the foreign MNE's forward integration into the U.S. market. It has not expressly covered the backward integration of the U.S. importer. But it is as feasible for a U.S. buyer to purchase material for importation through a related foreign agent as it is for foreign producers to establish U.S. selling arms. Again, in the context of our Trigger Price Mechanism we have heard of a growth of this practice that will require us to investigate the basis on which the MNE, viewed as a single entity,

has acquired the goods for use in this country.

(3) Related party component suppliers. As MNE's diversify their production and distribution locations, a new phenomenon has come to light unforeseen by prior drafters of legislation or regulations. Plants in country "A" may be acquiring at dumping prices from related -- or unrelated -- companies in country "B" the principal components of products then produced or assembled for sale to the U.S. and elsewhere. For example transistors may be sold in country A by a producer in country B at prices below those charged in B. The buyer of the transistors in A then produces an article in which transistors are used -- such as hand held calculators -- that it can sell at uniformly low prices in its home market and the U.S. If the calculator producer in "A" were unrelated to the transistor supplier in "B", it is doubtful that our antidumping law would reach the imports of calculators. On the other hand, were the transistor and calculator producers part of a single MNE, the transactions between them could be collapsed so that an analysis under §205(b) of the Act might reveal that the calculators were produced below their cost of production.

A recent proceeding initiated by the Canadian government with respect to twine from the United States seeks to address this problem under the countervailing duty law. The Canadian government contends the production and export of sisal and jute --

the raw materials from which the U.S. producers of twine are making their finished product -- are being subsidized by the governments of the sisal and jute growers. Quaere whether dumping of such raw materials might be regarded as a "private subsidy" within the meaning of a countervailing duty statute.

(4) Related party absorption of costs of production. The classical definition of dumping is "injurious price discrimination." And the history of the U.S. law aimed at its prevention as well as its text reflect a preference for price tests as the measure of dumping. Thus, §202(a) of the Act permits reference to the "constructed value" of merchandise to determine the amount of dumping duty to be collected only "in the absence" of a foreign market value derived from home or third country prices. The same preference is expressed in §205(b), defining "foreign market value" -- but with the new gloss that is reshaping international thinking on the meaning of "dumping."

Section 205(b), added to our law by the Trade Act of 1974, states that in computing the "foreign market value" of merchandise for purposes of setting the reference against which sales to the U.S. are to be measured, sales in the home market made at prices below the cost of production shall be disregarded. If insufficient sales above cost remain to establish a "foreign market value" for the goods, their "constructed value" is to be used as the reference price. Section 205(b)

provides lawyers and accountants with rich opportunities for debate on such questions as the time period within which the subject costs are to be examined (how long, is it prior to the period of sales examined), and the manner in which fixed costs are to be allocated to the goods produced during the period of investigation. But for present purposes other issues are of primary interest, namely, the manner in which parent company investments in operating companies should be treated and the appropriate accounting for intra-company services usual to an MNE for everything from preferential interest rates on loans based on parent company guarantees to allocations of global expenses for executive salaries, insurance, R&D and advertising, legal or accounting services.

It seems well established that the "cost of producing" the merchandise for the purposes of §205(b) requires a determination of the full costs -- not just marginal costs. Moreover, although the legislative history of the section requires general recognition of the accounting practices of the individual respondent in determining that firm's "costs", it also cautions such figures may be misleading and permits restatement of costs to avoid "distortions."

Based on this caution, domestic petitioners in a number of recent cases have urged the creation of a charge to an operating arm of an MNE whose working capital may technically have been provided in the form of an equity investment by a parent (or affiliated finance or holding) company, but which

could arguably be traced to a bank loan to, or other debt instrument issued by, the parent or other affiliated company. Or if the operating company itself borrowed money based on a parent company guarantee we have been urged to value the guarantee as an added "cost" of producing the merchandise even though it would not normally appear on the producer's own books. To date we have resisted such arguments and declined to look into the sources of an investor's funds, whether or not the investor was related to the producing company.

On the other hand when an operating company's books plainly fail to include appropriate charges for such matters as accounting, legal and advertising services that are in fact absorbed on its behalf by a parent or service affiliate, we have not hesitated to impute an appropriate charge to the operating firm (generally based on a percentage of sales methodology).

These are not simply the hidden byways off the highway of our administration. These are the streets that will bear the heavy traffic of future antidumping investigations. Authorities of the major countries presently applying anti-dumping measures (the U.S., the European Community, Canada and Australia) met during 1978 to consider certain "priority issues" arising in their administration of their antidumping laws. High on the list were the problems associated with sales at below the cost of production. Each recognized that this has, indeed, become the critical bellwether of dumping. Why this belated realization?

-- First, as governments everywhere have come to realize the social and political problems created by unemployment, they have increasingly adopted measures to avoid or soften the impact of industrial conditions that could lead to unemployment. It is, therefore, deemed desirable policy to produce goods -- even if at a loss -- to avoid what may be regarded as even less tolerable problems associated with unemployment or the shut down of historically productive facilities. But the idea of "exporting unemployment" through below cost sales can hardly be viewed with equanimity by importing countries. Not infrequently the conditions that have led to slack demand and potential unemployment in the exporting country -- changes in the world economy, changes in consumer tastes, obsolete facilities or technology -- are no less keenly felt in the importing country. Thus the latter may -- must -- protect itself against undue adjustment burdens.

-- Second, the industrialized Northern Hemisphere has recognized the desirability of stimulating the development of the less developed South. Such development has assumed political advantages in the form of greater stability. It has assumed humanitarian and social values in lifting peiple out of subsistence

living. It has presumed economic values in creating customers for our products who are able to pay for their purchases. Old programs on a bilateral and multinational basis have proliferated and a variety of other preferences have been accorded the LDC's. The latter have on not infrequent occasions used these aids to develop local industries that produce goods mainly for export. Export sales are used to acquire foreign exchange needed to pay for the material and intellectual property that means "development." Concommitantly, home market sales are often discouraged through high local prices. The automatic application of traditional antidumping measures in such cases would run counter to the larger development goal. Accordingly, a cost analysis may be the only fair way to establish the propriety of imposing antidumping measures on LDC imports. And so the United States has proposed in the GATT -- so far without acceptance by the most outspoken of the LDC's.

-- Third, growing government involvement in the actual operation of industries has made prices less reliable indicators of real values. When governments assume total control of an industry -- or, more, an entire economy -- the traditional constraints of supply and demand no longer exert the discipline that any price

discrimination law must assume exists. In such situations a cost analysis would appear the fairest way to gauge whether comparative advantage in fact lies with the foreign producer offering products at appealing low prices.

In a word, the cost-of-production approach to the dumping question seems best able to get to the root question: Which producer has true comparative advantage? If the foreigner, then it may be appropriate for U.S. industry to accept what can be painful and expensive problems of adjustment. If, on the other hand, the foreigner cannot demonstrate the comparative advantage low prices should reflect, then it must bear the adjustment burdens and not shift them to us.

Obviously, such calculations are not easily made. They also take time, something we are generally accused of taking too much of and that we know we are always too short of! But they are the "stuff" of the future, most particularly in weighing imports by MNE's.

It has been suggested to us that we adopt a rule of thumb comparable to that found in the Internal Revenue Code, under which companies related by at least an 80% common ownership would be treated as a single entity and separate corporate organizations would be disregarded. But the related entities providing services or goods to the actual exporter may be in

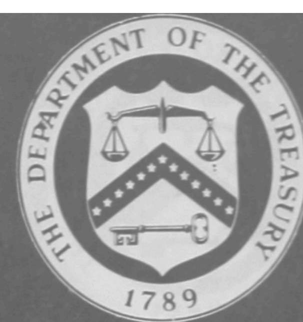
multiple jurisdictions. The type of audit needed of a conglomerate MNE in order to ascertain the true costs incurred by its operating subsidiaries could well be excessive for the gain achieved. On the other hand, perhaps we need to adopt rules of thumb that would ordinarily be applied in the absence of contrary proof.

As we look to the future, what do we see?

Surely no diminution in the role of MNE's in trade nor their involvement in our cases. But one development that should help us derives from the concepts of the Customs Valuation Code that is emerging from the Multilateral Trade Negotiations that should wind up in the next few weeks. Under that Code, related party transaction prices will not presumptively be disregarded; if reflective of arms' length dealing, they can become the basis for normal customs duty valuation. It may be that the trauma of a dumping case should always render related party transactions suspect; they don't present the ordinary customs valuation situation. Nevertheless, if we can believe assertions that the separate components of many MNE's do, indeed, deal with one another on arms'length terms, we will have hopefully saved substantial resources that will unquestionably need to be turned to the investigations we must foresee. I say that with neither the despair of an overworked government bureaucrat nor the optimism of a practitioner in the field.

* * *

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



For Immediate Release
February 22, 1979

Contact: Robert E. Nipp
202/566-5328

TREASURY ANNOUNCES SUBSCRIPTIONS RECEIVED FOR DM NOTE SALE

The Department of the Treasury today announced that it has received approximately DM 5.0 billion in total subscriptions for its offering of DM 2.5 billion of 2-1/2 year notes and 3-1/2 year notes denominated in Deutschemarks. Subscriptions received for the 2-1/2 year notes were DM 2,713 million and for the 3-1/2 year notes were DM 2,242 million. Allotments between each maturity will be announced later today.

# # #

B-1418

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

FOR IMMEDIATE RELEASE
February 22, 1979

Contact: Robert E. Nipp
202/566-5328

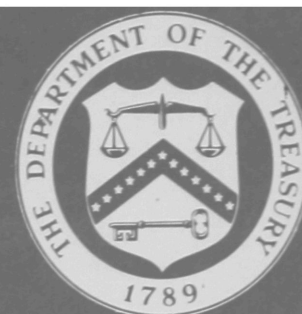
TREASURY ANNOUNCES RESULTS OF DM NOTE SALE

The Department of the Treasury today announced that it is accepting a total of DM 2,502 million in subscriptions for its issues of two and one-half-year and three and one-half-year notes denominated in Deutsche marks. A total amount of DM 4,955 million in subscriptions for these issues was received.

The Treasury accepted DM 1,260 million in subscriptions for its two and one-half-year notes. Total subscriptions received for this issue were DM 2,713 million. In the case of the three and one-half year notes, the Treasury accepted DM 1,243 million in subscriptions. Total subscriptions received for this issue were DM 2,242 million. These acceptances represent allocations of 46 percent of subscriptions for two and one-half-year notes and 55 percent for the three and one-half-year maturity. In each of the two maturities, allocations are being made on a pro rata basis. Individual subscriptions, however, are being rounded up to the nearest DM 250,000.

B-1419

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



FOR RELEASE AT 4:00 P.M. February 20, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,000 million, to be issued March 1, 1979. This offering will result in a pay-down for the Treasury of about $200 million as the maturing bills are outstanding in the amount of $6,209 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,000 million, representing an additional amount of bills dated November 30, 1978, and to mature May 31, 1979 (CUSIP No. 912793 Y7 5), originally issued in the amount of $2,904 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated March 1, 1979, and to mature August 30, 1979 (CUSIP No. 912793 2J 4).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 1, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,674 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, 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, Monday, February 26, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) 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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders 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 on all accepted tenders 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. 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.

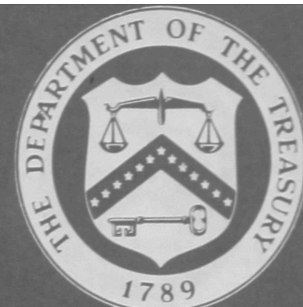
Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action 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 weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt on March 1, 1979, in cash or other immediately available funds or in Treasury bills maturing March 1, 1979. Cash adjustments will be made for differences between the par value of the 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 these bills 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 these bills (other than life insurance companies) must include in his or her 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 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



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TREASURY DEPARTMENT

FOR IMMEDIATE RELEASE
February 23, 1979

Contact: Robert E. Nipp
202/566-5328

TREASURY ANNOUNCES RESULTS OF GOLD SALE

The Department of the Treasury announced that 1,500,100 troy ounces of fine gold were sold yesterday to 13 firms and individuals who bid successfully at a sealed bid sale. Awards of 1,000,000 troy ounces of gold in 400 ounce bars whose fine gold content is 99.5 to 99.94 percent were made to 10 successful bidders at prices from $251.76 to $254.16 per ounce, yielding an average price of $252.38 per ounce. Bids for this gold were submitted by 16 bidders for a total amount of 2.0 million ounces at prices ranging from $240.00 to $254.16 per ounce.

Awards of 500,100 troy ounces of gold in 300 ounce bars whose fine gold content is 89.9 to 90.1 percent were made to 6 successful bidders at prices from $250.77 to $252.76 per ounce, yielding an average price of $251.42 per ounce. Bids for this gold were submitted by 14 bidders for a total amount of 1.3 million ounces at prices ranging from $244.20 to $252.76 per ounce.

Gross proceeds from today's sale were $378.1 million. Of the proceeds, $63.3 million will be used to retire Gold Certificates held by Federal Reserve Banks. The remaining $314.8 million will be deposited into the Treasury as a miscellaneous receipt.

The list of the successful bidders and the amount of gold awarded to each is attached. The General Services Administration will release details on the individual awards later.

The current sale was the tenth in a series of monthly auctions being conducted by the General Services Administration on behalf of the Department of the Treasury. The next sale, at which 1,500,100 ounces will be offered, will be held on March 20, 1979. At this sale, 1,000,000 fine troy ounces will be offered in bars whose fine gold content is 99.50 to 99.94 percent. The minimum bid for these bars will be for 400 fine troy ounces. A total of 500,100 ounces will be offered in bars whose fine gold content is 89.9 to 90.1 percent. The minimum bid for these bars will be 300 fine troy ounces. Bids for bars in each fineness category will be evaluated separately.

B-1421

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Firm	Fine Troy Ounces
Bank Julius Bar Co. Ltd. Zurich, Switzerland	14,000
Credit Suisse Zurich, Switzerland	99,600
Derby & Co., Ltd. London Wall, England	4,000
Dresdner Bank Frankfurt, W. Germany	982,600
E. F. Hutton & Co. New York, N.Y.	99,900
Gerald Metals, Inc. New York, N.Y.	9,600
Gold Standard Corp. Kansas City, Mo.	400
Johnson Matthey Bankers Ltd. London, England	4,000
Republic National Bank of N.Y. New York, N.Y.	169,800
Sharps Pixley, Inc. New York, N.Y.	64,000
Simmons Refining Co. Chicago, Illinois	600
Swiss Bank Corp Zurich, Switzerland	45,200
Valeur White Weld Geneva, Switzerland	6,400

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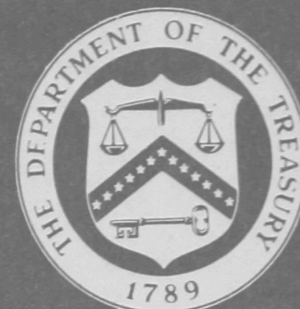

FOR IMMEDIATE RELEASE
February 23, 1979

CONTACT: Charles Arnold
566-2041

FOREIGN BANKS MUST REGISTER REPRESENTATIVE OFFICES

The Department of the Treasury today announced that foreign banks with representative offices in the United States must register with the Department by March 17 by filing a brief report on each such office, and thereafter file a report on any new office on the date it is established.

The regulations, provided for in the International Banking Act of 1978, will be published in the Federal Register of February 28, 1979. The information required, which may be submitted to the Secretary of the Treasury in letter form, comprises: (a) name and address of the head office; (b) name and address of the representative office; (c) name of person in charge of the office, and (d) description of the activities of the office.

A representative office is defined as one maintained by a foreign bank which engages in representational functions common to a banking business such as solicitation of new business, loan production, liaison between the bank's head office and correspondent banks in the United States, customer relations, etc. A foreign bank is defined as one organized under the laws of a foreign country, a territory of the United States, Puerto Rico, Guam, America Samoa, or the Virgin Islands.

In addition to being available at Treasury, copies of the regulations will be obtainable at local Federal Reserve Banks and branches.

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B-1422

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

31 CFR Part 123

REGISTRATION OF REPRESENTATIVE

OFFICES OF FOREIGN BANKS

FINAL REGULATION

AGENCY: Department of the Treasury

ACTION: Final Regulation

SUMMARY: Section 10 of the International Banking Act of 1978, Pub. L. No. 95-369, requires that foreign banks register their representative offices in the United States with the Secretary of the Treasury. This Part specifies the information to be supplied and the steps to be followed in registering such offices.

EFFECTIVE DATE: This part is effective February 28, 1979.

FOR FURTHER INFORMATION CONTACT:

David W. Heleniak
Assistant General Counsel (Domestic Finance)
Department of the Treasury
Washington, D.C. 20220
(202) 566-8625

SUPPLEMENTARY INFORMATION: This Part implements the provisions of Section 10 of the International Banking Act of 1978, Pub. L. No. 95-369. The regulation establishes registration requirements with respect to representative offices of foreign banks consistent with the requirements of the Act and its legislative history.

Because the sole purpose of this Part is to implement recently enacted legislation by establishing a simple registration process to facilitate data collection concerning certain activities of foreign banks in the United States, the Secretary for good cause finds that the procedures prescribed by 5 U.S.C. 553 relating to notice, public procedure and delayed effective date are unnecessary. Nevertheless, interested persons may submit written comments to the Assistant General Counsel (Domestic Finance), Department of the Treasury, Washington, D.C. 20220. Comments will be reviewed and acted upon in the same manner as if this Part were in proposed form, but the Part shall remain in effect until further amendments, if any, are proposed. This Part does not meet Treasury criteria for a significant regulation.

DRAFTING INFORMATION: The principal drafter of this part is Larry A. Mallinger, Attorney, Office of the Comptroller of the Currency, Washington, D.C. 20219. However, personnel from other offices of the Treasury Department participated in developing the regulation, both on matters of substance and style.

Accordingly, the Secretary amends 31 CFR by adopting Part 123 to read as follows:

PART 123 -- Registration of Representative Offices of Foreign Banks

Sec

123.1 Scope of Regulation
123.2 Definitions
123.3 Information Required to be Filed
123.4 Subsequent Changes in Information
123.5 Time of Registration
123.6 Effect of State Law
123.7 Additional Information

AUTHORITY: The provisions of this Part 123 are issued pursuant to Section 10, International Banking Act of 1978, Pub. L. No. 95-369 (the "Act").

§123.1 Scope of Regulation

This regulation requires that foreign banks with representative offices in any State of the United States or in the District of Columbia register with the Secretary of the Treasury and report the information called for in Sections 123.3, 123.4 and 123.7.

§123.2 Definitions

(a) Representative Office -

For the purposes of this Part, a representative office shall be defined as an office of a foreign bank which engages in representational functions common to a banking business such as, without limitation, solicitation of new business, loan production, liaison between the bank's head office and correspondent banks in the United States, customer relations, etc. Branches and agencies of foreign banks are not representative offices.

(b) Foreign Bank -

For the purposes of this Part, a foreign bank shall be defined as any company organized under the laws of a foreign country, a territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands, which engages in the business of banking, or any subsidiary or affiliate, organized under such laws, of any such company. The term "foreign bank" includes, without limitation, foreign commercial banks, foreign merchant banks and other foreign institutions that engage in banking activities usual in connection with the business of banking in the countries where such foreign institutions are organized or operating. The term "foreign bank" does not include central banks of foreign countries which are not engaged in a commercial banking business in the United States.

§123.3 Information Required to be Filed

The information required under this Part must be submitted in letter form by a foreign bank over the signature of an appropriate executive officer of the bank to Secretary of the Treasury, Department of the Treasury, 15th & Pennsylvania Avenue, NW, Washington, D.C. 20220, attention: Office of International Banking and Portfolio Investment. A foreign bank may register more than one representative office in any letter. The information required in each letter shall be:

(a) Name and address of the head office of the foreign bank;

(b) Name(s) and address(es) of its representative office(s) in the United States;

(c) Name of the person(s) in charge of the representative office(s); and

(d) Brief description of the activities of the representative office(s).

§123.4 Subsequent Changes in Information

Any change in the information supplied under Section 123.3 shall be submitted to the Treasury, at the address noted in Section 3, within 60 days of such change.

§123.5 Time of Registration

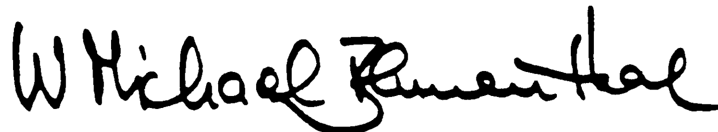
Foreign banks must register representative offices under this Part by March 17, 1979 or the date on which the office is established, whichever is later.

§123.6 Effect of State Law

Neither the Act nor this Part authorizes the establishment of any representative office in any State in contravention of State law.

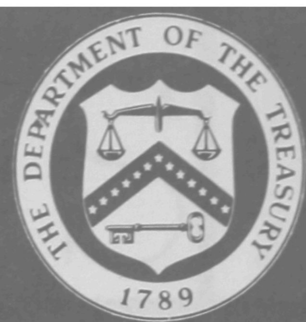
§123.7 Additional Information

Additional information concerning registered representative office(s) shall be furnished from time to time to the Treasury, at the address noted in Section 123.3, upon the specific request of the Secretary of the Treasury or his delegates.



W. Michael Blumenthal
Secretary of the Treasury

epartment of the TREASURY NEWS
ASHINGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
February 23, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT FINDS RAYON
STAPLE FIBER FROM ITALY IS SOLD
HERE AT LESS THAN FAIR VALUE

The Treasury Department today announced it has determined that viscose rayon staple fiber imported from Italy is being sold in the United States at "less than fair value."

The case is being referred to the U. S. International Trade Commission, which must decide within 90 days whether a U. S. industry is being, or is likely to be, injured by these sales. If the decision of the Commission is affirmative, dumping duties will be collected on sales found to be at less than fair value. Appraisement has been withheld since a tentative decision was issued on November 16, 1978.

The weighted average margin of sales at less than fair value in this case was 18.6 percent, computed on all sales.

Interested persons were offered the opportunity to present oral and written views prior to this determination.

(Sales at less than fair value generally occur when imported merchandise is sold in the United States for less than in the home market.)

Imports of viscose rayon staple fiber from Italy during the period November 1977-April 1978 were valued at about $49,000.

Notice of this determination appears in the Federal Register of February 23, 1979.

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federal financing bank NEWS
WASHINGTON, D.C. 20220
Press inquiries: 202-566-2615

FOR IMMEDIATE RELEASE February, 23, 1979

FEDERAL FINANCING BANK ACTIVITY

Roland H. Cook, Secretary, Federal Financing Bank (FFB), announced the following activity for January 1-31, 1979.

Guaranteed Lending Programs

During January, FFB signed two loan agreements guaranteed by the Department of Defense (DOD) under the Arms Export Control Act. On January 5, FFB signed a $35 million loan agreement with the Government of the Republic of Korea. Advances made under this agreement will mature June 30, 1987. On January 26, FFB signed a $70 million loan agreement with the Government of Greece. Advances made under this agreement will mature February 1, 1989. Also during January, FFB made 29 advances totalling $135,128,644.71 to 16 governments under existing DOD-guaranteed loan agreements.

Under notes guaranteed by the Rural Electrification Administration, FFB advanced a total of $76,436,000 to 25 rural electric and telephone systems.

On January 24, FFB purchased a total of $11,355,000 in debentures issued by 15 small business investment companies. These debentures are guaranteed by the Small Business Administration, mature in 3, 5, 7 and 10 years, and carry interest rates of 9.715%, 9.385%, 9.335%, and 9.305%, respectively.

FFB provided the Western Union Space Communications, Inc. with the following advances which mature October 1, 1989 and carry annual interest rates.

Date	Amount	Interest Rate
1/2	$2,750,000	9.676%
1/22	9,000,000	9.65%
1/24	3,000,000	9.446%

These advances are part of FFB's $687 million financing of a satellite tracking system to be constructed by Western Union and used by the National Aeronautics and Space Administration, which guarantees repayment of these advances.

During January, FFB purchased the following General Services Administration Participation Certificates:

Series	Date	Amount	Maturity	Interest Rate
K-015	1/5	$2,876,960.25	7/15/04	9.175%
M-041	1/11	4,537,365.58	7/31/03	9.194%
L-050	1/17	1,073,301.54	11/15/04	9.208%

Department of Transportation-Guaranteed Lending

FFB advanced funds to the following railroads under notes guaranteed by DOT under Section 511 of the Railroad Revitalization and Regulatory Reform Act:

	Date	Amount	Maturity	Interest Rate
Trustee of Chicago, Rock Island	1/10	$ 938,974.00	12/10/93	9.617% an.
Trustee of The Milwaukee Road	1/12	1,294,105.00	11/15/91	9.605% an.
Chicago & North Western Trans.	1/15	2,019,300.00	3/1/89	9.641% an.

Under Note #17, which matures February 16, 1979, FFB lent the following amounts to the National Railroad Passenger Corp. (Amtrak):

Date	Amount	Interest Rate
1/8	$ 8,500,000.00	9.485%
1/12	10,000,000.00	9.635%
1/15	3,500,000.00	9.685%
1/23	6,000,000.00	9.80
1/25	6,500,000.00	9.813%

On January 30, FFB lent Amtrak $6.5 million at a rate of 9.807% under Note #18. This note matures March 30, 1979.

Agency Issuers

The Tennessee Valley Authority (TVA) sold FFB a $40 million Note on January 15, a $20 million Note on January 29, and a $90 million Note on January 31. These notes mature April 30, 1979 and carry interest rates of 9.967%, 9.855%, and 9.824%, respectively. Also on January 31, TVA sold FFB a $500 million Series A Power Bond. This bond will mature February 28, 1989, and carries an interest rate of 9.296%. Of the total $650 million borrowed, $490 million retired maturing securities, and $160 million raised new cash.

In its weekly short-term FFB borrowings, the Student Loan Marketing Association (SLMA), a federally-chartered private corporation which borrows under a Department of Health, Education and Welfare guarantee, refunded $280 million in maturing securities. FFB holdings of SLMA notes total $915 million.

On January 23, FFB purchased a $620 million Certificate of Beneficial Ownership from the Farmers Home Administration. This certificate matures January 23, 1984, and carries an interest rate of 9.595%, on an annual basis.

FFB Holdings

As of January 31, 1979, FFB holdings totalled $52.2 billion. FFB Holdings and Activity Tables are attached.

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FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

January 31, 1979

Program	January 31, 1979	December 31, 1978	Net Change (1/1/79-1/31/79)	Net Change-FY 1979 (10/1/78-1/31/79)
On-Budget Agency Debt				
Tennessee Valley Authority	$ 5,795.0	$ 5,635.0	$ 160.0	$ 575.0
Export-Import Bank	6,898.3	6,898.3	-0-	330.0
Off-Budget Agency Debt				
U.S. Postal Service	2,114.0	2,114.0	-0-	-0-
U.S. Railway Association	345.4	355.7	-10.3	-11.4
Agency Assets				
Farmers Home Administration	24,445.0	23,825.0	620.0	2,170.0
DHEW-Health Maintenance Org. Loans	57.0	57.0	-0-	-0-
DHEW-Medical Facility Loans	163.7	163.7	-0-	-0-
Overseas Private Investment Corp.	38.0	38.0	-0-	-2.2
Rural Electrification Admin.-CBO	637.7	637.7	-0-	-0-
Small Business Administration	105.9	107.3	-1.4	-6.3
Government Guaranteed Loans				
DOT-Emergency Rail Services Act	17.3	17.5	-0.2	-0.2
DOT-Title V, RRRR Act	53.5	49.2	4.3	17.7
DOD-Foreign Military Sales	4,384.4	4,284.8	99.5	406.5
General Services Administration	305.8	297.4	8.5	35.7
Guam	36.0	36.0	-0-	-0-
DHUD-New Communities Admin.	38.5	38.5	-0-	-0-
Nat'l. Railroad Passenger Corp. (AMTRAK)	351.3	478.2	-126.9	-183.1
NASA	294.9	280.1	14.8	58.3
Rural Electrification Administration	4,680.1	4,603.7	76.4	488.6
Small Business Investment Companies	279.0	267.6	11.4	28.3
Student Loan Marketing Association	915.0	915.0	-0-	170.0
Virgin Islands	21.6	21.8	-0.2	-0.2
WMATA	177.0	177.0	-0-	-0-
TOTALS	$52,154.2*	$51,298.5	$ 855.8*	$4,076.7

*Totals do not add due to rounding.

FEDERAL FINANCING BANK

January 1979 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST RATE (other than s/a)
Department of Defense					
Thailand #2	1/2	$ 136,098.62	6/30/83	9.849%	
Thailand #3	1/2	4,826.00	9/20/84	9.721%	
Spain #1	1/3	7,130,300.34	6/10/87	9.577%	
Spain #2	1/3	2,540,140.00	9/15/88	9.503%	
Haiti #1	1/3	106,950.00	3/12/83	9.907%	
Haiti #2	1/3	106,898.00	3/12/84	9.784%	
Thailand #3	1/9	14,373.00	9/20/84	9.692%	
Peru #2	1/10	1,000,000.00	4/1/84	9.746%	
Panama #2	1/10	71,511.86	3/31/83	9.868%	
Tunisia #5	1/10	635,161.00	6/1/86	9.57%	
Malaysia #3	1/11	41,103.20	3/20/84	9.753%	
Ecuador #2	1/15	2,399,461.29	8/25/84	9.736%	
Haiti #2	1/15	384,279.45	3/12/84	9.736%	
Jordan #3	1/15	163,186.20	12/31/86	9.547%	
Turkey #2	1/15	3,628,667.60	10/1/86	9.56%	
Tunisia #4	1/15	924,599.55	10/1/85	9.611%	
Honduras #2	1/18	89,000.00	10/7/82	9.929%	
Tunisia #4	1/19	146,513.00	10/1/85	9.615%	
Colombia #2	1/22	94,225.00	9/20/84	9.661%	
Israel #6	1/22	2,394.89	1/12/08	9.22%	
Israel #7	1/22	112,823,322.10	12/15/08	9.214%	
Liberia #3	1/22	372,464.27	6/30/84	9.676%	
Jordan #2	1/25	360,026.40	11/26/85	9.483%	
Taiwan #2	1/26	517,205.91	12/31/82	9.655%	
Colombia #2	1/26	429,516.75	9/20/84	9.433%	
Ecuador #2	1/26	238,547.49	8/25/84	9.437%	
Malaysia #3	1/29	94,194.44	3/20/84	9.437%	
Thailand #2	1/30	338,667.00	6/30/83	9.514%	
Korea #8	1/31	335,011.35	12/31/86	9.237%	
Farmers Home Administration					
	1/23	620,000,000.00	1/23/84	9.375%	9.595% annually
General Services Administration					
Series K-015	1/5	2,876,960.25	7/15/04	9.175%	
Series M-041	1/11	4,537,365.58	7/31/03	9.194%	
Series L-050	1/17	1,073,301.54	11/15/04	9.208%	
National Railroad Passenger Corp. (Amtrak)					
Note #17	1/8	8,500,000.00	2/16/79	9.485%	
Note #17	1/12	10,000,000.00	2/16/79	9.635%	
Note #17	1/15	3,500,000.00	2/16/79	9.685%	
Note #17	1/23	6,000,000.00	2/16/79	9.80%	
Note #17	1/25	6,500,000.00	2/16/79	9.813%	
Note #18	1/30	6,500,000.00	3/30/79	9.807%	
Rural Electrification Administration					
Big River Electric #58	1/2	1,697,000.00	1/2/81	10.155%	10.029% quarterly
Big River Electric #91	1/2	512,000.00	1/2/81	10.155%	10.029% "
Northern Michigan Elect. #101	1/2	1,936,000.00	1/2/82	9.765%	9.649% "
Allegheny Electric #93	1/2	2,536,000.00	12/31/13	9.159%	9.056% "
Arkansas Electric #97	1/2	4,243,000.00	12/31/13	9.159%	9.056% "
Tri-State Gen. & Trans. #79	1/3	2,504,000.00	12/31/85	9.415%	9.307% "
Tri-State Gen. & Trans. #89	1/3	6,296,000.00	12/31/85	9.415%	9.307% "
Glacier State Telephone #29	1/4	2,381,000.00	1/4/81	10.155%	10.029% "
Sierra Telephone #59	1/4	40,000.00	1/31/81	10.105%	9.98% "
Dairyland Power #36	1/9	5,000,000.00	12/31/13	9.168%	9.065% "

FEDERAL FINANCING BANK

January 1979 Activity

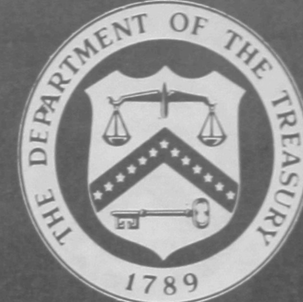
BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST RATE (other than s/a)
Rural Electrification Administration (cont.)					
Wolverine Electric #100	1/10	$ 1,350,000.00	1/10/81	10.095%	9.971% quarterly
M & A Electric #111	1/10	501,000.00	1/10/81	10.095%	9.971% "
Northern Michigan Elect. #101	1/10	1,725,000.00	1/10/82	9.782%	9.668% "
Allegheny Electric #93	1/10	2,164,000.00	12/31/13	9.176%	9.073% "
Wabash Valley Power #104	1/10	48,000.00	12/31/13	9.176%	9.073% "
Pacific Northwest Gen. #118	1/10	1,191,000.00	12/31/13	9.176%	9.073% "
Golden Valley Electric #81	1/11	297,000.00	1/11/81	10.115%	9.99% "
Western Illinois Power #99	1/12	2,407,000.00	1/12/81	10.095%	9.971% "
Tri-State Gen. & Trans. #79	1/12	2,399,000.00	12/31/85	9.395%	9.287% "
So. Mississippi Electric #3	1/16	230,000.00	1/19/81	10.085%	9.961% "
Alabama Electric #26	1/17	7,000,000.00	1/17/81	10.095%	9.971% "
Corn Belt Power #55	1/19	2,151,000.00	1/19/81	10.095%	9.971% "
East Kentucky Power #73	1/22	6,371,000.00	1/22/81	10.085%	9.961% "
Big River Electric #58	1/22	1,146,000.00	1/22/81	10.085%	9.961% "
Big River Electric #91	1/22	3,265,000.00	1/22/81	10.085%	9.961% "
Tri-State Gen. & Trans. #37	1/23	100,000.00	12/31/85	9.335%	9.229% "
Gulf Telephone #50	1/23	365,000.00	12/31/13	9.157%	9.055% "
Arizona Electric #60	1/23	1,666,000.00	12/31/13	9.157%	9.055% "
So. Mississippi Electric #3	1/24	316,000.00	1/26/81	10.025%	9.902% "
So. Mississippi Electric #4	1/24	244,000.00	1/26/81	10.025%	9.902% "
So. Mississippi Electric #90	1/24	680,000.00	1/26/81	10.025%	9.902% "
Continental Tele. of Missouri #65	1/25	2,490,000.00	12/31/81	9.625%	9.512% "
Doniphan Telephone #14	1/26	175,000.00	12/31/13	9.04%	8.94% "
Hillsborough & Montgomery Tele. #48	1/30	257,000.00	12/31/13	9.046%	8.946% "
Sierra Telephone #59	1/31	265,000.00	1/31/81	9.855%	9.737% "
Continental Tele. of Kentucky #115	1/31	4,000,000.00	1/31/81	9.855%	9.737% "
Southern Illinois Power #38	1/31	360,000.00	1/31/82	9.355%	9.248% "
Tri-State Gen. & Trans. #89	1/31	5,164,000.00	12/31/85	9.135%	9.033% "
Basin Electric #88	1/31	964,000.00	12/31/13	9.048%	8.948% "
Small Business Investment Companies					
Enervest, Inc.	1/24	200,000.00	1/1/82	9.715%	
Lloyd Capital Corp.	1/24	500,000.00	1/1/82	9.715%	
Tomlinson Capital Corp.	1/24	150,000.00	1/1/82	9.715%	
Enervest, Inc.	1/24	400,000.00	1/1/84	9.385%	
Charles River Resources, Inc.	1/24	2,000,000.00	1/1/86	9.335%	
The Christopher SBIC	1/24	1,000,000.00	1/1/89	9.305%	
Clarion Capital Corp.	1/24	2,000,000.00	1/1/89	9.305%	
Coastal Capital Corp.	1/24	500,000.00	1/1/89	9.305%	
Commercial Capital, Inc.	1/24	625,000.00	1/1/89	9.305%	
ESIC Capital, Inc.	1/24	400,000.00	1/1/89	9.305%	
First Texas Investment Co.	1/24	250,000.00	1/1/89	9.305%	
Florists' Capital Corp.	1/24	500,000.00	1/1/89	9.305%	
Hanover Capital Corp.	1/24	430,000.00	1/1/89	9.305%	
Intercapco, Inc.	1/24	750,000.00	1/1/89	9.305%	
SBIC of Panama City, Fla.	1/24	400,000.00	1/1/89	9.305%	
Small Business Invest. Capital, Inc.	1/24	1,250,000.00	1/1/89	9.305%	
Student Loan Marketing Association					
Note #177	1/2	55,000,000.00	4/3/79	9.874%	
Note #178	1/9	40,000,000.00	4/10/79	9.799%	
Note #179	1/16	45,000,000.00	4/17/79	9.900%	
Note #180	1/23	70,000,000.00	4/24/79	9.769%	
Note #181	1/30	70,000,000.00	5/1/79	9.807%	
Tennessee Valley Authority					
Note #90	1/15	40,000,000.00	4/30/79	9.967%	
Note #92	1/29	20,000,000.00	4/30/79	9.855%	
Note #91	1/31	90,000,000.00	4/30/79	9.824%	
Power Bond, Series A	1/31	500,000,000.00	2/28/89	9.296%	

FEDERAL FINANCING BANK

January 1979 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST RATE (other than s/a)
Department of Transportation-Section 511					
Trustee of Chicago, Rock Island	1/10	$ 938,974.00	12/10/93	9.396%	9.617% annually
Trustee of The Milwaukee Road	1/12	1,294,105.00	11/15/91	9.385%	9.605% annually
Chicago & North Western Trans.	1/15	2,019,300.00	3/1/89	9.419%	9.641% annually
United States Railway Association					
Note #8	1/3	4,208,773.76	4/30/79	9.925%	
Note #8	1/8	5,525,000.00	4/30/79	10.105%	
Western Union Space Communications, Inc. (NASA)					
	1/2	2,750,000.00	10/1/89	9.453%	9.676% annually
	1/22	9,000,000.00	10/1/89	9.428%	9.65% annually
	1/24	3,000,000.00	10/1/89	9.233%	9.446% annually

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



FOR RELEASE AT 1:45 P.M. February 23, 1979

TREASURY OFFERS $4,000 MILLION OF 48-DAY TREASURY BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $4,000 million of 48-day Treasury bills to be issued March 2, 1979, representing an additional amount of bills dated October 19, 1978, maturing April 19, 1979 (CUSIP No. 912793 X9 2).

Competitive tenders will be received at all Federal Reserve Banks and Branches up to 12:30 p.m., Eastern Standard time, Tuesday, February 27, 1979. Noncompetitive tenders will not be accepted. Tenders will not be received at the Department of the Treasury, Washington. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. The price on tenders offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

The bills will be issued on a discount basis under competitive 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 in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account.

B-1425

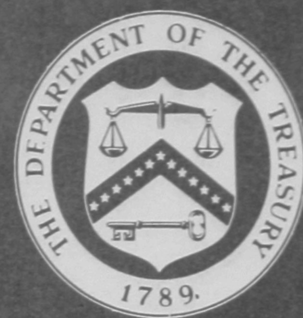
No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches, or for bills issued in bearer form, where authorized. A deposit 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 tenders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately available funds on Friday, March 2, 1979.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills 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 these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills 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 Circulars, No. 418 (current revision), 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 may be obtained from any Federal Reserve Bank or Branch.

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



FOR IMMEDIATE RELEASE February 26, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,000 million of 13-week Treasury bills and for $3,002 million of 26-week Treasury bills, both series to be issued on March 1, 1979, 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 31, 1979			26-week bills maturing August 30, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.630	9.376%	9.76%	95.199 a/	9.496%	10.14%
Low	97.604	9.479%	9.87%	95.195	9.504%	10.15%
Average	97.611	9.451%	9.84%	95.198	9.498%	10.14%

a/ Excepting 2 tenders totaling $20,000

Tenders at the low price for the 13-week bills were allotted 53%.
Tenders at the low price for the 26-week bills were allotted 100%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 20,460,000	$ 20,460,000	$ 16,730,000	$ 11,730,000
New York	4,411,505,000	2,600,055,000	5,241,715,000	2,727,455,000
Philadelphia	18,990,000	18,990,000	57,060,000	7,060,000
Cleveland	28,095,000	28,095,000	65,860,000	12,760,000
Richmond	17,585,000	17,585,000	10,965,000	10,965,000
Atlanta	31,260,000	31,260,000	21,975,000	21,975,000
Chicago	166,370,000	96,670,000	348,815,000	102,420,000
St. Louis	41,455,000	27,455,000	46,080,000	15,080,000
Minneapolis	4,750,000	4,750,000	2,705,000	2,705,000
Kansas City	26,765,000	26,765,000	16,760,000	14,755,000
Dallas	9,645,000	9,645,000	11,875,000	7,875,000
San Francisco	163,470,000	108,470,000	351,260,000	55,260,000
Treasury	10,035,000	10,035,000	11,570,000	11,570,000
TOTALS	$4,950,385,000	$3,000,235,000 b/	$6,203,370,000	$3,001,610,000 c/

b/Includes $370,275,000 noncompetitive tenders from the public.
c/Includes $198,870,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

B-1426

epartment of the TREASURY
NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
February 26, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT WITHDRAWS
PROPOSED FIREARMS REGULATIONS

The Treasury Department today said it is withdrawing various proposed firearms regulations published in the Federal Register on March 21, 1978.

These regulations would have required unique serial numbers stamped on every firearm by manufacturers, and quarterly reports to the Bureau of Alcohol, Tobacco and Firearms on all sales or other dispositions of firearms between licensed manufacturers, importers and dealers. They would not have required reports of the names or addresses of private citizens who purchase firearms.

These proposals, which generated the most comments from the public, will not be considered again in the foreseeable future.

ATF will continue to review the other proposals being withdrawn and consider whether some or all should be proposed again in the same or modified form. These proposals include requirements that licensees report thefts of firearms, modifications in procedures for members of the Armed Forces bringing private firearms into the United States and adjustments in procedures for transporting National Firearms Act firearms, telephone reporting by licensees of firearms transactions, and provisions to reduce the paperwork involved when returning firearms for repair or replacement.

Last year Congress voted to prohibit the use of appropriated funds to implement these regulations.

Treasury Assistant Secretary Richard J. Davis announced the withdrawal of the regulations at an appearance today before the House Appropriations Subcommittee for Treasury, Postal Service and General Government. The announcement was filed today with the Federal Register.

During his testimony Mr. Davis also stated that the Justice Department has decided not to appeal a recent decision by the U. S. District Court in Washington that ATF had statutory authority to promulgate regulations providing for security requirements for licensed premises. The court ruled on the issue

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(MORE)

after the Treasury Department rejected a petition submitted by the National Council to Control Handguns (NCCH) and the NCCH then sued the Department. Under the court decision, ATF, which had previously stated it did not have authority to issue such a regulation, must now consider this issue on its merits. Consideration will be given to whether it should issue an Advanced Notice of Proposed Rulemaking on this subject to secure additional information, particularly as to the cost-benefit of such an approach, before determining whether to make any proposals in this subject area.

Assistant Secretary Davis said, at the hearing, that the Department wanted to give the newly appointed Director of ATF an opportunity to review all of these matters.

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partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE ON DELIVERY
February 28, 1979 -- 10:00 a.m. EST

STATEMENT OF THE HONORABLE RICHARD J. DAVIS
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT AND OPERATIONS)
BEFORE THE
SUBCOMMITTEE ON AVIATION OF THE HOUSE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
ON
H.R. 1834
"AN ACT TO COMBAT INTERNATIONAL TERRORISM"

I appreciate the opportunity to appear again before this Subcommittee in order to discuss the explosive tagging provisions of H.R. 1834 and other House bills which address the problems associated with international terrorism. Accompanying me today are Mr. G. Robert Dickerson, the new Director of the Bureau of Alcohol, Tobacco, and Firearms, Mr. John Krogman, Deputy Director, Mr. A. Atley Peterson, also of BATF, and Dr. Robert Moler of the Aerospace Corporation.

As you know, Mr. Chairman, in the Ninety-Fifth Congress we presented a detailed statement of the Treasury Department's reasons for supporting the adoption of explosives tagging legislation. Rather than repeat all that was said at that time, I will today present an overview of what the explosives tagging program is intended to accomplish, why Federal legislation is needed, and what kind of legislation is most desirable. As an attorney and former Federal prosecutor, my primary experience has involved dealing with how to investigate and prosecute crimes after they have been committed. But my responsibilities for the protective as well as the investigative enforcement activities of the Treasury Department demand a perspective which gives at least equal weight to the ability of government to prevent criminal activities, especially those employing violence.

Consequently, I have followed closely the development, under BATF and Aerospace auspices, of capabilities for introducing into non-military explosives those unique elements -- taggants -- which would permit identification and detection of explosives. Very simply, the explosives tagging system would work as follows. Identification tagging involves the insertion of a taggant in an explosive material which would survive intact after an explosion and be recovered by bomb scene investigators. The taggant itself would reveal the type of explosive involved, its manufacturer, and the date and shift when it was made. From this, the explosive could be traced through the distribution chain from manufacturers, to retailers and, in many instances, to the last, or a group of possible last, legal owners of the explosive. Detection taggants would emit a vapor which could be detected before the explosive containing them was detonated; the presence of bombs could, thus, be detected and lives and property saved.

These techniques, some of which could be implemented nationally in 1979 if we had the authority, offer law enforcement and security authorities an opportunity to use science and technology not only to solve more bombing crimes but also to prevent their occurrence. In this manner, a comprehensive explosive tagging program can significantly enhance the public safety.

Because of the benefits derived from developing practical tagging capabilities, the Treasury Department and ATF testified several times during the 95th Congress in support of the passage of legislation which would provide us with the necessary authority to require that non-military explosives which are manufactued or imported in the United States carry taggants. While that legislation did not reach a vote in that Congress, its importance has not diminished; and we continue to support the passsage of tagging legislation during the 96th Congress. We continue to urge the adoption of a legislative requirement for explosive tagging because it will provide us with significant tools in the battle against terrorists and others who use explosives illegally.

The extent to which tagging will help counter bombing crimes will be largely influenced by how quickly and how many forms of explosives are tagged. It is very important,

therefore, that as soon as technology allows, the requirement that a particular class of explosives be tagged should go into effect. One class of explosives -- dynamites, water gels and slurries -- is ready for identification tagging now; black powder will be shortly. Tagging for the other types is expected to be ready at different times throughout the next three years. Following is a chart reflecting the status of development for tagging the various categories of explosives. It describes the dates we expect tagging could begin to be implemented if legislation is passed in this session and if sufficient taggants are then available.

IDENTIFICATION TAGGING

-- Black Powder, June 1979
-- Smokeless Powder, July 1981
-- Dynamites, water gels & slurries, June 1979
-- Fuse and Detonating Cord, November 1979
-- Boosters, March 1980
-- Detonators, June 1981 (label method)
October 1981 (double plug method)

DETECTION TAGGING

-- Black Powder, October 1980
-- Smokeless Powder, October 1980
-- Dynamites, water gels & slurries, October 1980
-- Fuse and Detonating Cord, October 1980
-- Boosters, January 1981
-- Detonators, January 1981 (both single plug methods)
June 1981 (label method)
October 1981 (double plug method)
-- Detection Taggant Sensors, April 1981 through March 1982 (implementation of different devices)

Changes, both positive and negative, from the schedule projected last summer are due to various factors, including scientific developments, the lack of legislation, and delays in securing testing agreements with some manufacturers.

We urge that legislation be passed during this session which provides the Secretary with the necessary authority to require tagging of all types of non-military explosives in

order that we can minimize the delay in getting tagged explosives into the marketplace and maximize our ability to apprehend those who use bombs and to save the lives of their intended victims at the earliest possible time. Elimination of particular classes of explosives from this legislation will, we fear, provide a disincentive for the producers of those explosives to cooperate with the development and testing of tagging. The passage of comprehensive legislation, on the other hand, will provide a stimulus which would accelerate the process by which tagging of all explosives used in crimes could be accomplished.

The enactment of tagging legislation in a piece-meal fashion also will minimize and, likely, defeat the timely impact on bombing crimes which tagging might have. For example, if we were to achieve legislative authority that permits us to institute identification tagging for the dynamites, water gels and slurries (which are ready for national identification tagging) but not for other explosives, we would not be able to respond rapidly to the expected shift from dynamites to other forms of explosives; and that shift will receive impetus because of these exclusions. Instead, we will have to: (1) continue to perfect tagging of those categories of explosives not ready today, (2) submit additional legislation to authorize the tagging requirement for those types, (3) go through additional sets of hearings to cover again the testimony already given on this, and (4) if the additional legislation then passes, wait for the taggant manufacturers and explosive manufacturers to gear up for production and use of the taggants in these other types of explosives. This will be a very lengthy process giving bombers years of immunity from the tagging of what are already commonly used explosives in bombs such as black and smokeless powders.

On the other hand, if we have a single, comprehensive bill -- with the requirements that all taggants be safe, suitable, non-damaging, and available, and with the discretionary authority to make exemptions or delays when needed -- the only step remaining once taggants for these other types of explosives are ready will be to institute the tagging requirement. This approach will not authorize the inclusion of taggants before it is safe to do so; tagging will happen only after tests, participated in by the manufacturers, have been completed successfully.

Passage of a comprehensive bill is also necessary so that the manufacturers of taggants and explosives will be prepared to invest willingly the resources needed to have production and distribution facilities ready. They will do so only if they know that there is a legal requirement for compliance and that the tagging requirement will be implemented on a certain date. This certainly can only be achieved through a comprehensive tagging bill.

The Department recognizes that some have urged that black and smokeless powders be excluded from this program because they are used lawfully by sportsmen. H.R. 1834 adopts such an approach. We cannot endorse this exclusion. All explosives have both lawful and unlawful uses. Black and smokeless powders are not only used by the law-abiding; they are also used by the bombers. For example, among all bombings in 1978 recorded by ATF -- including unidentifiables and incendiaries -- black and smokeless powders were used in 18.5 percent of the total bombings. FBI figures for this period attribute 22.1 percent to the powders. A chart presenting a statistical analysis of the various explosives used in crime is attached to my testimony. Together, those powders equal <u>less than one percent</u> of the commercially available explosives, yet their frequency of occurrence in bombings is <u>several magnitudes greater</u> than their proportional availability.

Given this situation, a program that excludes these powders is of questionable value. Such an exclusion would encourage the increased use of powders in bombs; taggant detectors would have little benefit if they could not detect the large numbers of black and smokeless powder bombs; and the cost-benefit of identification tagging would be reduced.

Mr. Chairman, the Treasury Department firmly believes, however, that the enactment of tagging legislation must assure that this program proceeds under the most rigorous and objective standards of research, development and testing. One measure of precaution that we recommended was incorporated in some of the legislative proposals in the last Congress and is repeated in subsection (t) of the explosives taggants provisions of H.R. 1834 and section 9(b) (10) of H.R._ _ _ _,

respectively. We therefore fully support the explicit requirement that authority be created so that the insertion of taggants in any type of explosive, including the powders, can be deferred until that type of tagged explosive is found to have all-around safety, that the taggants would not affect the performance of the explosive or of a weapon using it, that they would be available in sufficient quantities to avoid any interruption in the ordinary course of producing explosives and that they would be environmentally sound. These precautions ensure that the lawful user of these materials -- ranging from the shooter to the mining company -- is protected, as is the public, from the bomber. Fortunately the technology being developed is meeting this challenge. It is, we are certain, our joint desire to assure that each step of the program continues to do so.

From Treasury's perspective another vital issue for tagging has been whether the crimes solved and the deterrence established are worth the effort and costs of requiring the taggants. In order to assess this as objectively as possible, Management Science Associates was asked to study this question. While acknowledging the difficulty in assessing the impact of any program before it begins, the study concluded, and we believe, that the value and cost effectiveness of identification tagging is clear.

Detection tagging is the part of the tagging program from which the greatest direct benefits to the public safety can be expected. With detection taggants added to explosive materials and with detection devices placed at high target value locations, we can go beyond solving bombing crimes only after the destruction has happened and begin, through pre-detonation discovery, to prevent bombings from occurring. The MSA study suggests that the cost-benefit of this form of tagging is less certain than that for identification tagging. Its analysis makes clear, however, that if one considers just the high risk, potential targets -- airports, planes, public buildings -- then the benefits are clear. In addition, when one considers what detection tagging can do -- save life and limb -- the essentiality of going forward with this program becomes clearer.

We also do not seek to tag those types of explosives seldom found in any bombings. We have no desire to impose burdens on commercial enterprises or private pursuits that do not have a clear public benefit. For example, we are not seeking to require the tagging of those smokeless powders inserted in commercially manufactured, fixed ammunition. Only powders for sale in bulk quantities should be tagged. We take this position because there is no measurable public benefit to achieve by tagging individual rounds of ammunition.

Furthermore, we will not require the tagging of blasting agents. The greatest portion (80 percent) of the materials produced for use in commercial blasting is made up of blasting agents, the most common of which is a mixture of ammonium nitrate and fuel oil known as ANFO. The components of ANFO are not explosives until compounded at the blasting site. Then they nearly always require a booster and detonator in order to be exploded. Both boosters and detonators are going to be tagged under this program since they nearly always occur in criminal use of high explosives. Thus, their tagging will also provide the tracing mechanism for blasting agents, and we will not have to undertake the massive and costly job of requiring that blasting agents themselves be tagged. Tagging of the boosters and detonators is cheaper, more readily applicable, and will have a much greater impact on bombings than tagging of the blasting agents which almost never are used in crime.

Mr. Chairman, in addition to specific safety and other protections which we have already described, we propose that an obligation be placed on Treasury and the Bureau of Alcohol, Tobacco and Firearms to report to the Congress at least annually on the results of the operating parts of the tagging program: costs, the incidence of discovery of taggants at bomb scenes, and the incidence of pre-explosion bomb detections through taggants. In addition, the status, including any cost changes, of development which is not yet completed should be reported each year. Such a report will enable Congress to continue to evaluate this program. We will be happy to work with the Subcommittee staff in developing this and other proposals designed to assure the proper implementation of this program.

Mr. Chairman, we believe the benefits of tagging are clear. It will not, of course, provide a panacea, instantly solving the problem of explosives crime. Identification tagging will help solve some bombings, not all. Detection tagging does not mean that all bombs will immediately be detected. Together, however, they will meaningfully advance our ability to deal with the bombing problem and deter some from using this deadly instrument. Those would be major life saving advances.

That concludes my statement, Mr. Chairman. Director Dickerson has a brief prepared statement, and we will then be glad to answer any questions.

Department of the Treasury Statement February 28, 1979, Subcommittee on Aviation, House Committee on Public Works and Transportation

February 26, 1979

Attachment

1978

Distribution of Explosives in Crime

	FBI			ATF		
	Number	Percent Known	Percent w/Unknown	Number	Percent Known	Percent w/Unknown
Incendiary	636	39.30	34.60	468	36.10	26.50
Black Powder	196	12.10	10.70	171	13.20	9.70
Smokeless Powder	209	13.00	11.40	157	12.10	8.80
Military	133	8.20	7.20	55	4.20	3.10
Dynamite	173	10.70	9.40	251	19.40	14.20
Other	271	16.70	14.70	194	15.00	11.00
Subtotals	1618	100.00		1296	100.00	
Unknown	219		12.00	471		26.70
Totals	1837		100.00	1767		100.00
Black & Smokeless (Shown as percentage of known)		25.10			25.30	
Black & Smokeless (Percentage including unknowns)			22.10			18.50
Black & Smokeless (Percentage excluding incendiaries & unknowns)		40.8			39.6	

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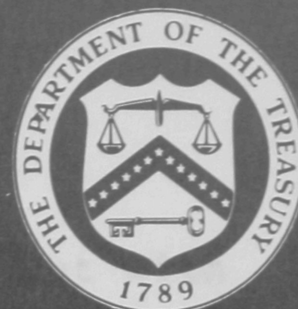

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
FEBRUARY 28, 1979

TESTIMONY OF THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE
SENATE COMMITTEES ON GOVERNMENT AFFAIRS
AND ON BANKING, FINANCE AND URBAN AFFAIRS

Thank you for the opportunity to present the views of the Administration on S. 332, a proposal to consolidate the Federal bank regulatory agencies.

For more than forty years, Congress and the Executive Branch have considered proposals to reorganize the Federal agencies charged with the regulation of banks. These proposals have sought to rationalize the complex, and to some extent overlapping, jurisdictions of the Board of Governors of the Federal Reserve System, the Comptroller of the Currency and the Federal Deposit Insurance Corporation. Each of these agencies is charged with the examination and supervision of segments of the banking industry, and each has substantial personnel devoted to similar activities. This structure is a product of history, and it is doubtful that anyone starting with a clean slate would design the regulatory system we have today. Nevertheless, the system has on the whole operated well. This country has the strongest banking system in the world. The level of failures in recent years does not call into question the basic structure of the system.

On the other hand, it is clear that in a few areas the present system falls short of optimum performance. A frequently mentioned illustration is found in the examination and supervision of bank holding company systems. Most regulators agree that holding companies and their bank and nonbank affiliates should be examined in a process that recognizes that they are a single entity and that transgressions in one part

of a system will inevitably affect other portions. But with the Comptroller examining the national banks in the group, the FDIC examining nonmember state banks in the system, and the Federal Reserve examining state member banks, the holding company and its nonbank affiliates, a consistent and integrated result has not always emerged.

Similarly, in recent years the bank regulators have been hard pressed to keep up with expansion of bank activities abroad and in highly technical areas such as currency trading and data processing. Each regulator supervises some banks that pursue such activities, and thus each must develop an increasingly sophisticated cadre of examiners. Some have asserted that it would be easier and more efficient to develop one -- rather than three -- specialized examination groups and thus increase the likelihood that a satisfactory technical level of competence is developed and maintained.

The present system is sometimes uneven in its treatment of comparable situations and in its response to emerging problems. From time to time disagreements among the regulators have frustrated uniform policies and created competitive inequities.

Thus, there are good reasons to consider reorganization or consolidation. S. 332 would consolidate the three agencies under a single five member commission. This is the most ambitious of the proposed reorganization suggestions. While in the long-term this may well be the desirable structure, the Administration does not recommend implementation of that solution for a number of reasons.

First, with the recent passage of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 and the Community Reinvestment Act, the regulators are under considerable pressure to implement a number of important and complex new requirements. Consolidation would unquestionably interfere with that process by diverting staff and causing personnel assignment uncertainties.

Second, in-depth consideration of consolidation legislation may well doom any early passage of legislation solving the membership problem of the Federal Reserve. Pending proposals deserve early consideration, but as a practical matter there is every chance that they will be linked to the consolidation issue if that issue is seriously considered, and chances of early passage would not be enhanced.

Third, implementation of S. 332 will involve very considerable personnel resource and logistic problems. The integration of three separate agencies can be a traumatic and disruptive step. Indeed, rationalizing three non-parallel regional systems will in itself pose very significant problems. The solutions to these questions should evolve over a substantial period of experimentation with increasing uniformity of regulation and proceedings among the regulators. Trying simultaneously to accomplish both substantive uniformity and structural reorganization could strain the system beyond prudent limits.

Fourth, S. 332 does not fully address the issues raised by those who are concerned about the fate of the dual banking system. This Committee is aware that fears have been expressed that a monolithic Federal bank regulatory agency would effectively swamp the state regulators. By providing for Federal funding and certification of qualifying state regulators, S. 332 would facilitate co-existence. But it cannot fully answer the assertion that he who controls the purse strings will also ultimately set the standards.

It has been suggested by some that a preferable intermediate position is a reorganization that would result in two Federal agencies, one that would examine and supervise national banks and the other state banks. It is argued that such a structure would best preserve the integrity of a dual banking system while reducing a significant portion of the present duplication. But this proposal necessarily sacrifices some of the goals of efficiency and effectiveness sought by the proponents of reorganization. There are also other variations that would accommodate concerns in this area, but all raise complex issues that will not be quickly and easily resolved.

How are these competing and sometimes conflicting interests to be resolved? The proper accommodation is, I would suggest, most difficult to determine when the steps we take are large and the impact on existing institutions is great. If, instead, change takes place in smaller steps, the result more closely approaches a natural evolution. It was that kind of evolutionary process that the Administration had in mind in supporting the creation by the Congress less than four months ago of the Federal Financial Institutions Examination Council -- Title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

Under the terms of the new law, the Council will be established on March 10, 1979. Its members will consist of the Comptroller of the Currency, the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, a Governor of the Board of Governors of the Federal Reserve designated by the Chairman of the Board of Governors, the Chairman of the Federal Home Loan Bank Board, and the Chairman of the National Credit Union Administration.

The law provides the Council with several functions that are the key to the development of a consistent and effective regulatory scheme. First, the law directs the Council to establish uniform principles, standards and report forms for the examination of financial institutions which shall be applied by the member agencies of the Council. Second, the Council is to make recommendations for uniformity in other supervisory matters. If a member agency finds a recommendation unacceptable, the agency must submit to the Council, within a time period specified by the Council, a written statement of reasons that the recommendation is unacceptable. Third, the law provides that the Council is to develop uniform reporting systems for the regulated financial entities. Finally, the Council is to conduct schools for the examiners of the member agencies. Each of the agency members is to bear one-fifth of the expenses of the Council. Work on implementing the provisions of the new law is well advanced and on March 10, the Council should be fully operative.

In establishing the Council, the Congress has taken a major step in promoting consistent regulation of financial institutions. For the first time, we have an institutional mechanism -- with statutory authority -- to coordinate the activities of the regulatory agencies. This is a step that we should build upon, for it holds the promise of resolving many of the problems that have been identified in the regulation of financial institutions today and of providing the basis for more formal consolidation should that appear warranted in a few years.

We believe it is entirely appropriate for this Committee to consider now the form that consolidation of these agencies should take. We would suggest, however, that enhancement of the Council is the logical interim step to consolidation -- should it eventually be enacted. It should be integrated in any plan for ultimate consolidation so that substantive progress in critical areas is achieved before the necessity

of accommodating dislocations that come with full consolidation. We would be pleased to provide any assistance we can to the Committee in this process.

The initial experience in implementing the provisions of the new law have pointed to some areas where changes in, or clarification of, the operations of the Council may be appropriate. Our suggestions may be summarized as follows:

1. It should be made clear that the Council's coordinating function includes the examination and supervision of all entities examined by the bank regulatory agencies, including bank holding companies and their nonbank affiliates, Edge Act corporations, agreement corporations and the like.

2. The role of the Federal Home Loan Bank Board and the National Credit Union Administration should be changed and the role of the Treasury should be clarified.

3. The method of financing the Council's operations should be altered.

The Coordinating Role

The enormous expansion of the bank holding company form of organization in the last two decades has resulted in many new activities being conducted by banking groups and of some functions previously conducted by banks being conducted now by a holding company or its nonbank affiliates. This in turn has complicated the responsibilities for examination and supervision and the actual conduct of examinations.

The need for coordination of examination and supervision of these activities and those of other nonbank affiliates is plain. Indeed, the lack of institutional arrangements to assure coordination has led some to suggest that the administration of the Bank Holding Company Act, which is presently lodged exclusively with the Federal Reserve, should be divided and allocated to the prime regulator of the major banks in each group. In our view, the Council should promptly undertake to address the problems in this area before a more drastic legislative solution is enacted.

That may require clarification of the Council's authority. Certain provisions of the statute imply that the Council will be involved in developing uniform reporting systems for bank holding companies and in making recommendations as to supervisory problems with bank holding companies. On the other hand, the definition of "financial institution" in the legislation creating the Council includes only depository institutions. To avoid any ambiguity about what the Council is to do, the Congress may wish to amend the definition so that bank holding companies, their nonbank subsidiaries, Edge Act corporations, agreement corporations and any other entities subject to examination and supervision by the regulators, are included within the group that must be coordinated. This change will assure that the Council's coordinating role is comprehensive and that an important feature of current financial regulation is fully integrated into a uniform regulatory scheme.

Membership

The law provides for equal participation by the bank regulatory agencies and the more specialized savings and loan and credit union regulatory agencies. Yet most of the work of the Council will not involve matters where coordination with the thrift institutions is relevant. We would suggest that the objectives sought to be achieved by including them in the Council can be better achieved by making the Administrator of the National Credit Union Administration and the Chairman of the Federal Home Loan Bank Board advisory members of the Council. Neither would act as chairperson, and actions of the Council would not be binding upon their agencies or the institutions they regulate. In addition, the Treasury has for many years participated on the regulators' interagency coordinating committee. It would be appropriate that the Treasury continue in this role as an advisory member of the Council.

Financing

It also seems clear that it is not equitable, at least as the activities of the Council are now envisaged, for the Federal Home Loan Bank Board and the National Credit Union Administration to have an equal share of the costs

and expenses of the Council. Also the resources of the agencies themselves are vastly different, as reflected in their budgets and sources of income. The use of Council facilities such as the examination schools may vary among the agencies, and some recognition of differences in resource utilization would seem to be in order.

Accordingly, we recommend that the basic costs of the Council be paid from the FDIC insurance fund. The FDIC insurance fund is supported by assessments on all banks regulated by the Federal banking agencies and it thus would be an equitable means of sharing the Council's basic costs. In addition, the Council would charge each agency for the use of particular services or facilities such as the examination schools. This use charge would more equitably match costs and benefits. It would also allow the National Credit Union Administration and the Federal Home Loan Bank Board to participate in these services or facilities without incurring costs for the overall operation of the Council. The effect of these proposed changes will be to provide a more sound basis for financing the Council and to free the agencies from internal budgetary concerns that might otherwise impede the development of the Council and its functions.

* * *

Mr. Chairman, that concludes my formal testimony. We would be pleased to submit proposed legislation to implement these changes.

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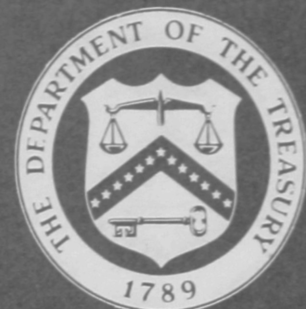

FOR IMMEDIATE RELEASE February 27, 1979

RESULTS OF TREASURY'S 48-DAY BILL AUCTION

Tenders for $4,001 million of 48-day Treasury bills to be issued on March 2, 1979, and to mature April 19, 1979, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon Issue Yield)
High -	98.714	9.645%	9.93%
Low -	98.704	9.720%	10.01%
Average -	98.707	9.698%	9.99%

Tenders at the low price were allotted 69%.

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

Location	Received	Accepted
Boston	$ 35,000,000	$ 35,000,000
New York	7,648,000,000	3,378,050,000
Philadelphia	---	---
Cleveland	---	---
Richmond	70,000,000	13,450,000
Atlanta	10,000,000	8,450,000
Chicago	986,000,000	351,250,000
St. Louis	25,000,000	---
Minneapolis	15,000,000	15,000,000
Kansas City	26,000,000	16,000,000
Dallas	100,000,000	50,000,000
San Francisco	330,000,000	133,450,000
TOTAL	$9,245,000,000	$4,000,650,000

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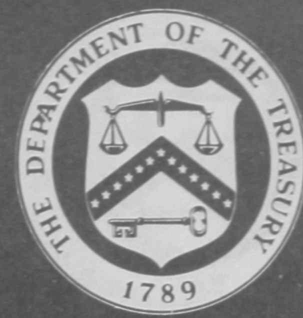

FOR IMMEDIATE RELEASE February 27, 1979

RESULTS OF AUCTION OF 4-YEAR 1-MONTH TREASURY NOTES

The Department of the Treasury has accepted $2,502 million of $6,734 million of tenders received from the public for the 4-year 1-month notes, Series D-1983, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	9.33% 1/
Highest yield	9.36%
Average yield	9.35%

The interest rate on the notes will be 9-1/4%. At the 9-1/4% rate, the above yields result in the following prices:

Low-yield price	99.705
High-yield price	99.605
Average-yield price	99.638

The $2,502 million of accepted tenders includes $538 million of noncompetitive tenders and $1,964 million of competitive tenders from private investors, including 24% of the amount of notes bid for at the high yield.

In addition to the $2,502 million of tenders accepted in the auction process, $ 395 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 three tenders totaling $53,000

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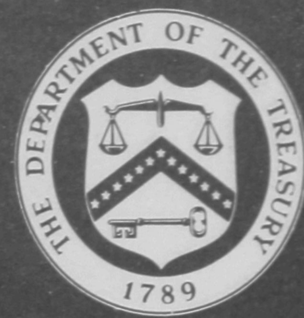

FOR IMMEDIATE RELEASE
February 28, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY TERMINATES ANTIDUMPING
INVESTIGATION OF CARBON STEEL
PLATE FROM UNITED KINGDOM

The Treasury Department today announced that it is terminating its antidumping investigation of carbon steel plate from the United Kingdom.

This investigation, along with investigations of the same merchandise from Belgium, France, Italy and the Federal Republic of Germany, were initiated by Treasury on January 9, 1979, after receipt of a complaint by Lukens Steel Co. The investigations of imports from the other four countries will continue.

The termination of the investigation of British imports was based on information indicating that there were no sales of this merchandise from the United Kingdom during the last half of 1978, and that shipments (comprising less than 100 tons) during that time were at prices not less than fair value. (Sales at "less than fair value" generally occur when imported merchandise is sold in the United States for less than in the home market.)

Lukens Steel Co. has stated in a letter to the Treasury that it does not object to the termination of this investigation insofar as it relates to steel from the United Kingdom.

Notice of this action appears in the Federal Register of February 28, 1979.

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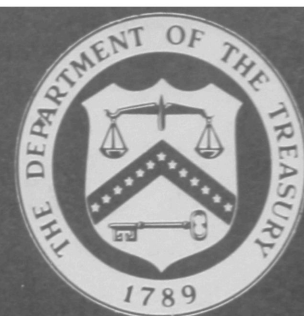

FOR IMMEDIATE RELEASE
February 28, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT DISCONTINUES
ANTIDUMPING INVESTIGATION OF VISCOSE
RAYON STAPLE FIBER FROM SWEDEN

The Treasury Department today announced that it has discontinued its investigation of viscose rayon staple fiber imports from Sweden.

Treasury's determination was based on its finding that margins of sales at less than fair value were minimal (i.e., about 0.5 percent), in relation to the volume of trade involved, and on formal assurances from the sole exporter that no future sales at less than fair value will be made to the U. S.

("Sales at less than fair value" generally occur when imported merchandise is sold in the United States for less than in the home market.)

Notice of this action appears in the Federal Register of February 28, 1979.

Imports of viscose rayon staple fiber from Sweden were valued at about $2.1-million during calendar year 1977.

o 0 o

February 28, 1979

Treasury Statement

The January balance of trade report incorporates a new system of seasonal adjustments, which results in substantial shifts in the monthly trade figures, although it does not affect the annual totals. The revised trade data show that the improvement in our overall trade position during the latter half of 1978 was even stronger than indicated under the old system.

The new adjustments result in significantly higher imports and a larger overall deficit for January than under the previous system which shows a further drop in the deficit for January. We continue to expect the 1979 trade balance to show real improvement. The revised figures for the latter half of 1978 support that expectation.

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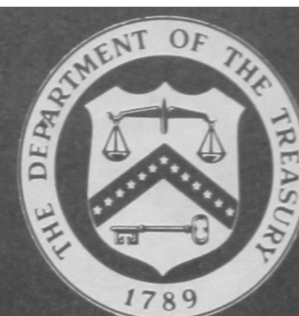

FOR IMMEDIATE RELEASE

February 28, 1979

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $3,320 million of 52-week Treasury bills to be dated March 6, 1979, and to mature March 4, 1980, were accepted at the Federal Reserve Banks and Treasury today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS: (Excepting 1 tender of $500,000)

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	90.415	9.480%	10.39%
Low -	90.401	9.494%	10.41%
Average -	90.410	9.485%	10.40%

Tenders at the low price were allotted 25%.

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

Location	Received	Accepted
Boston	$ 56,680,000	$ 25,680,000
New York	5,814,170,000	3,075,670,000
Philadelphia	17,565,000	2,565,000
Cleveland	76,210,000	14,710,000
Richmond	188,515,000	63,515,000
Atlanta	31,450,000	24,325,000
Chicago	358,865,000	23,615,000
St. Louis	52,385,000	22,635,000
Minneapolis	8,430,000	3,430,000
Kansas City	25,695,000	16,570,000
Dallas	4,955,000	4,955,000
San Francisco	403,065,000	37,540,000
Treasury	5,140,000	5,140,000
TOTAL	$7,043,125,000	$3,320,350,000

The $3,320 million of accepted tenders includes $ 138 million of noncompetitive tenders from the public and $1,588 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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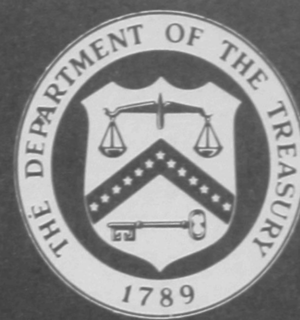

FOR RELEASE ON DELIVERY
EXPECTED AT 10:30 A.M.
March 2, 1979

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS

Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss the Administration's proposal for a system to control Federal credit programs, which the President announced in his January Budget Message. The new system would improve legislative and executive controls over credit programs and improve our focus on their overall financing requirements and their impacts on credit markets.

Under the Administration's proposal, annual limits on new lending under direct and guaranteed loan programs would be established in the regular budget and appropriations process. An overall, annual limit would be proposed in the President's budget, as well as a limit on each program. Aggregate ceilings could be set in the Congressional budget resolutions. Legally binding limitations for each individual budget account would be set in regular annual appropriation acts.

The major impact of the new system would be on loan guarantee programs. Opportunity now exists for review and control of direct loans in the regular budget and appropriations process, since most direct loan programs are included in the budget totals. Loan guarantee programs, however, largely

escape the budget process, since loan guarantees do not result in budget outlays (except in cases of default or where explicit subsidy payments are provided).

The new control system would not apply to Government-sponsored enterprises such as the Federal National Mortgage Association (FNMA), the Farm Credit System, and the Federal Home Loan Bank System. These agencies are entirely privately-owned and are largely self-supporting. Thus, they differ signficantly from Federal loan guarantee programs which are administered by Federally owned agencies and are effectively backed by the credit of the U.S. Treasury. However, even though the Government-sponsored enterprises would be excluded from the new Federal credit program control system, their activities should be taken into account in determining the overall Federal impact on total credit demands and on the allocation of credit to particular sectors of the economy.

Growth in Federal Loan Guarantees

Let me turn now to the specific problems of loan guarantees, which have been the principal focus of the Congressional committees interested in credit program controls. The table attached to my statement shows an estimated $333 billion of guaranteed loans outstanding at the end of FY 1980, an increase of $37.4 billion from the 1979 level. Thus, in FY 1980 the net demands on financial markets to finance Government loan guarantee programs will total $37.4 billion. As shown in the table, these demands have increased rapidly in recent years, from $16.2 billion in FY 1976 to $20.5 billion in FY 1977, $25.1 billion in FY 1978, and an estimated $32.8 billion in FY 1979.

By comparison, the net demands on financial markets to finance the Federal budget deficits during this period have been declining. They fell from $66.4 billion in FY 1976 to $45.0 billion in FY 1977, $48.8 billion in FY 1978, and an estimated $37.4 billion in FY 1979 and $29.0 billion in FY 1980. Thus, while budget deficit financing is expected to be cut by more than half in this 4-year period, the net off-budget financing required for loan guarantee programs will more than double.

A major reason for the proliferation of guarantees is the common misconception that they are cheaper and less risky to the Federal Government than direct loans. There is, however, no inherent difference, from the Federal viewpoint, between the costs and financial market effects of these two forms of credit.

The argument favoring guarantees relies primarily on experience with the largest and best known guarantee program -- the FHA's single family mortgage insurance program. This successful program, enacted during the great depression of the 1930's, assured private lenders that they could safely make long term, low down payment mortgage loans at reasonable interest rates, thus filling an important credit gap. Today, the FHA program's objectives are being achieved increasingly by private financial institutions without the need for Government intervention.

Unfortunately, FHA insurance has been the exception. A review of the programs covered in Special Analysis F of the Budget belies the argument that most guaranteed loan programs pose minimal costs to the Federal Government. Indeed, most involve substantial subsidies to borrowers and direct costs to the Treasury and, ultimately, the taxpayer.

Let me enumerate some of these subsidies:

-- <u>Principal subsidies</u>. In some cases, the Federal Government has extended loan guarantees with the expectation of paying part or all of the principal amount of the loan. The guaranteed loan is equivalent, therefore, to an outright grant of taxpayer funds. An extreme case is the public housing program, involving $15 billion of public housing note and bond guarantees (debt service contracts) outstanding. It is unlikely that public housing projects will generate sufficient revenues to service any of this debt. As a result, the Federal Government probably will make all interest and principal payments on this $15 billion.

-- Interest subsidies. Other guaranteed loan programs involve direct interest subsidies -- for example, rural community facilities, and subsidized private housing -- in addition to the subsidy implicit in the guarantee itself.

-- Default costs. Beyond these principal and interest subsidies, all guaranteed loans obviously involve Federal assumption of credit risks and thus potential costs to the Federal taxpayer in the event of unanticipated default.

Let me make a final comparison between direct loans and guaranteed loans. All loans involve three basic functions -- assuming risk, supplying funds and processing the loan.

Some argue that guarantees involve the Government only in risk assumption, and that the private sector supplies the funds and handles the paperwork. Yet another examination of the types of guarantees outstanding indicates that certain agencies issuing guarantees perform all three of these functions.

Specifically, several agencies, including HUD, HEW and Agriculture, make direct loans but then convert them into guarantees. In making the direct loans, they assume the risk, supply the funds and handle the processing. They then can sell the loans to private parties, however, continuing to guarantee them. A second example involves HUD's urban renewal program, which provides direct loan authority. Here, a commitment to make a direct loan is treated as a guarantee and sold by borrowers into the market.

Another misconception is that guaranteed loans are still largely financed by local lending institutions, with minimal Government involvement, and thus have little net impact on the securities markets. In fact, the $37.4 billion net financing requirements for loan guarantees in FY 1980 will be largely financed directly in the securities markets: An estimated $11.4 billion will be financed through the Federal Financing Bank, and thus by the Treasury; $10.5 billion will be financed by GNMA mortgage-backed securities; $3.1 billion by public housing bonds and notes; and additional amounts of securities market financing will be required for certain other guarantee programs such as the SBA, Farmers Home Administration, and the Maritime Administration.

Improved Standards For Issuing Guarantees

All of us also should address the need for better standards under which guarantee authority is provided by Congress in the first place.

It is clear that program agencies should be given more specific guidelines on the circumstances under which guarantees are to be provided and the related terms and conditions of them. Giving these agencies broad guarantee authority and then expecting them to resist the inevitable demands for guarantees unavoidably leads to serious problems of control over guarantee totals and general misallocation of our limited credit resources.

Let me discuss the basic circumstances in which guarantees are issued and make some suggestions for tightened loan guarantee standards and how they would help with the broader problem of controlling loan guarantee programs.

Credit need test. Most loan guarantee programs are intended to facilitate the flow of credit to borrowers who are unable to obtain credit in the private market. The needs of more creditworthy borrowers are expected to be met in the private market without Federal credit aid. To achieve this purpose more effectively, and to provide a built-in control over program growth, enabling legislation should be more specific on requiring evidence that borrowers cannot obtain credit from conventional lenders. Specifically, we think that legislation should require the guarantor agency to certify that, without the guarantee, borrowers would be unable to obtain credit on reasonable terms and conditions.

Coinsurance. In addition, guarantee programs are often intended to induce private lenders to extend loans on more favorable terms to marginal borrowers. The borrowers involved generally can obtain loans on their own, but only on costly and otherwise disadvantageous terms. In these cases, 100 percent guarantees don't make sense because they would lower the interest rate below that paid on unguaranteed loans to creditworthy borrowers for the same purposes. Doing so would stimulate a demand for guaranteed loans by creditworthy borrowers who do not need Federal credit aid.

To avoid such excessive demand for guarantees, we favor a much greater use of partial, rather than 100 percent guarantees. In the future, legislation generally should limit the guarantees to assume, say, 90 percent of the loan. Private lenders then would charge a higher rate of interest commensurate with project risk and with the rates charged on unguaranteed loans. Such risk-sharing, or coinsurance, by private lenders would contribute to the development of more normal borrower-lender relationships, would prompt lenders to exercise greater surveillance over the loans, and would stimulate increased conventional lending for the economic activities involved.

Guarantees of tax-exempt bonds. The Treasury opposes Federal guarantees of tax-exempt municipal bonds. They create a class of securities which is stronger than the Federal Government's own securities. Like Treasury securities, they would be backed by the full Federal credit but, unlike Treasuries, they would be exempt from Federal taxes. In addition, such guarantees would convey the benefits of both the Federal credit and the tax exemption to high income taxpayers -- the principal buyers of tax-exempt securities. Also, tax-exempt guarantees are an ineffective means of delivering Federal aid to local governments, since much of the benefit goes to high income investors and since the financing of Federal programs in the municipal market competes directly with other State and local bond issues for essential local public facilities and increases the cost of financing the facilities. For these reasons, we believe that municipal bonds should only be guaranteed if they are taxable securities.

Fixed interest rates. Another example of poor program structure, which leads to program control problems, involves loan guarantees where borrowers pay a fixed interest rate, and the Federal agency pays the difference between that rate and the market rate. Thus, as interest rates rise, there is an automatic increase in the Federal subsidy and in the demands on the Federal budget. The benefits to the assisted borrower are thus determined by fluctuations in the market rather than by changes in the borrower's real needs.

Excessive financing costs. Also to be avoided are guarantee programs which are financed directly in the securities markets at disproportionately high costs because of the small size or poor timing of the issue, the lack of investor familiarity with the program, or other special marketing factors. Many of these problems have been cured by financing such guaranteed obligations through the FFB.

Equity participation. Many guarantee programs involve circumstances where borrowers could take equity positions in the projects being financed, and these guarantee programs should encourage them to do so. Requiring borrowers to have such a stake would help avoid excessive demands for guarantees, help assure more efficient projects, and help protect the interests of the Federal Government as guarantor. This could be accomplished by a legislative requirement that the amount of guaranteed and unguaranteed loans not exceed, say, 90 percent of the value of the project being financed.

Other loan terms and conditions. Demands for guarantees will also be excessive if the authorizing legislation does not contain specific restrictions on such terms and conditions as maximum maturities, guarantee fees, reasonable assurance of repayment, and default procedures.

This is not to say that Federal credit assistance programs should not contain subsidies -- indeed, that is their purpose -- but the legislation should be carefully drafted so that the subsidies provided are by design, not chance, and are directed at specific needs.

In short, I believe that more effective Congressional control over loan guarantee programs can be accomplished by adopting standards which build that control into the structure of each guarantee program. I recognize that this is not an easy task, particularly since there are more than 100 different loan guarantee programs which fall under the jurisdiction of many different subcommittees of the Congress.

In the Executive Branch, the Office of Management and Budget and the Treasury Department strive to assure a uniform application of standards in the process of reviewing proposed guarantee legislation. Within Congress, however, it may be unrealistic for each interested subcommittee to develop the intense focus on guarantee standards which is essential to this improved control. Accordingly, it may be worthwhile for such a responsibility to be lodged in one committee of the Congress. Alternatively, the Congress could take the approach taken in the Federal Financing Bank Act or the Government Corporation Control Act and enact omnibus legislation to establish credit program standards.

I would be happy to answer any questions.

OoO

Net Increase in Federal and Federally Assisted
Borrowing from the Public
(fiscal years; billions of dollars)

Year	Federal borrowing from the public: Budget deficit	Off-budget deficit 1/	Other means of financing 2/	Total 3/6/	Federally assisted borrowing from the public: Guaranteed obligations	Sponsored agency obligations 4/	Deduct to avoid double counting 5/	Total	Total Federal and Federally assisted borrowing from the public
1970	2.8	-	2.6	5.4	6.4	10.7	5.6	11.5	16.9
1971	23.0	-	-3.6	19.4	16.1	1.5	3.4	14.2	33.7
1972	23.4	-	-3.9	19.4	18.8	5.0	4.6	19.2	38.6
1973	14.8	.1	4.4	19.3	15.2	8.8	- .7	24.7	44.0
1974	4.7	1.4	-3.1	3.0	10.1	14.9	4.0	21.0	24.1
1975	45.2	8.1	-2.4	50.9	16.4	11.9	14.4	13.9	64.7
1976	66.4	7.3	9.2	82.9	16.2	5.3	6.5	15.0	97.9
TQ	13.0	1.8	3.3	18.0	2.7	1.7	3.3	1.1	19.1
1977	45.0	8.7	- .1	53.5	20.5	7.0	2.0	25.5	78.9
1978	48.8	10.3	- .1	59.1	25.1	24.1	13.8	35.4	94.5
1979e	37.4	12.0	-9.4	40.0	32.8	13.3	12.7	33.4	73.4
1980e	29.0	12.0	-2.0	39.0	37.4	16.9	12.4	41.9	80.9
Net Change 1970-80	353.6	61.6	-5.1	410.0	217.7	121.1	82.0	256.8	666.8
Outstanding 9/30/80				689.9	333.4	146.5	96.4	383.5	1073.4

Office of the Secretary of the Treasury
Office of Government Financing

February 28, 1979

Source: Special Analysis E of the Fiscal Year 1980 Budget, January 1979.

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6/ 1976 figure excludes retroactive reclassification of $471 million of Export-Import Bank asset sales to debt.

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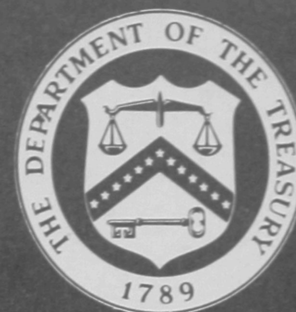

FOR RELEASE ON DELIVERY
EXPECTED AT 10:30 A.M.
March 2, 1979

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING AND URBAN AFFAIRS

Mr. Chairman and Members of the Committee:

I welcome this opportunity to discuss the Administration's proposal for a system to control Federal credit programs, which the President announced in his January Budget Message. The new system would improve legislative and executive controls over credit programs and improve our focus on their overall financing requirements and their impacts on credit markets.

Under the Administration's proposal, annual limits on new lending under direct and guaranteed loan programs would be established in the regular budget and appropriations process. An overall, annual limit would be proposed in the President's budget, as well as a limit on each program. Aggregate ceilings could be set in the Congressional budget resolutions. Legally binding limitations for each individual budget account would be set in regular annual appropriation acts.

The major impact of the new system would be on loan guarantee programs. Opportunity now exists for review and control of direct loans in the regular budget and appropriations process, since most direct loan programs are included in the budget totals. Loan guarantee programs, however, largely

escape the budget process, since loan guarantees do not result in budget outlays (except in cases of default or where explicit subsidy payments are provided).

The new control system would not apply to Government-sponsored enterprises such as the Federal National Mortgage Association (FNMA), the Farm Credit System, and the Federal Home Loan Bank System. These agencies are entirely privately-owned and are largely self-supporting. Thus, they differ signficantly from Federal loan guarantee programs which are administered by Federally owned agencies and are effectively backed by the credit of the U.S. Treasury. However, even though the Government-sponsored enterprises would be excluded from the new Federal credit program control system, their activities should be taken into account in determining the overall Federal impact on total credit demands and on the allocation of credit to particular sectors of the economy.

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A major reason for the proliferation of guarantees is the common misconception that they are cheaper and less risky to the Federal Government than direct loans. There is, however, no inherent difference, from the Federal viewpoint, between the costs and financial market effects of these two forms of credit.

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Unfortunately, FHA insurance has been the exception. A review of the programs covered in Special Analysis F of the Budget belies the argument that most guaranteed loan programs pose minimal costs to the Federal Government. Indeed, most involve substantial subsidies to borrowers and direct costs to the Treasury and, ultimately, the taxpayer.

Let me enumerate some of these subsidies:

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1973	14.8	.1	4.4	19.3	15.2	8.8	- .7	24.7	44.0
1974	4.7	1.4	-3.1	3.0	10.1	14.9	4.0	21.0	24.1
1975	45.2	8.1	-2.4	50.9	16.4	11.9	14.4	13.9	64.7
1976	66.4	7.3	9.2	82.9	16.2	5.3	6.5	15.0	97.9
TQ	13.0	1.8	3.3	18.0	2.7	1.7	3.3	1.1	19.1
1977	45.0	8.7	- .1	53.5	20.5	7.0	2.0	25.5	78.9
1978	48.8	10.3	- .1	59.1	25.1	24.1	13.8	35.4	94.5
1979e	37.4	12.0	-9.4	40.0	32.8	13.3	12.7	33.4	73.4
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Contact: Alvin M. Hattal
202/566-8381

TREASURY ANNOUNCES REVISIONS
IN CUSTOMS INVOICE REQUIREMENTS
FOR TRIGGER PRICE MECHANISM

The Treasury Department today announced a final rule amending the regulations requiring the presentation of a completed Special Steel Summary Invoice (SSSI), Customs Form 5520, to accompany each importation of steel mill products under the Treasury's "Trigger Price Mechanism" (TPM). The amendments were adopted to obtain certain information to improve the effectiveness of the TPM and to clarify certain existing requirements.

The new regulations generally implement the proposal published in the Federal Register on October 16, 1978, but they also reflect modifications to take account of comments received from the public.

Specific information not previously requested but now to be required on the SSSI concerns: (1) identification of the producer, (2) the sales price to the first unrelated U. S. purchaser in those cases in which the resale by a U. S. seller related to the foreign exporter is concluded before customs entry, (3) freight charges incurred after the merchandise is imported into the United States, (4) commissions paid or allowed, and (5) name of the importer.

Another change will increase the minimum value of a shipment for which an SSSI must be presented at entry from $2,500 to $10,000 except for importations from contiguous countries, where the minimum amount will be $5,000.

The principal changes effected by the amendments require the identification of the producer and, in certain related-party transactions, the sales price to the first unrelated purchaser in the United States. In this regard, the proposed amendments have been modified to take account of comments received.

The proposal to require ex-mill and subsequent sales prices has been limited considerably. The final rule provides that when the exporter and importer are related, the importer must provide the sales price to the first unrelated purchaser in the United States if the price is available at the time of entry. Thus, whenever the resale contract has been concluded before the

time of entry, this information must be provided. Failure to provide available resale information will constitute an incomplete submission of the SSSI, and the entry will be subject to rejection by Customs. If the resale price is not known at the time of entry because, for example, the merchandise is entering the importer's inventory, the international transaction price must be at or above the applicable trigger prices to avoid investigation. All entries committed to inventories must be adequately recorded to permit audit of resales and may be subject to additional reporting requirements.

If the foreign exporter and U. S. importer are not related parties, their international transaction price will continue to be compared to trigger prices. If the resulting comparison indicates a sale below the trigger price, the Department will consider the initiation of an antidumping proceeding.

If, in the course of its monitoring (including audits), the Department finds that a U. S. consumer of steel is using a foreign buying agent to avoid a direct sale from the foreign mill to that consumer so that the related firms, viewed as a whole, are acquiring steel below applicable trigger prices, the Department will consider the ex-mill price as the proper basis for comparison to the trigger price. This is consistent with prior practice in antidumping cases.

The instructions for completing the SSSI have also been amended to clarify the existing regulations relating to commissions and freight rates to ensure proper comparisons with applicable trigger prices. When a foreign seller pays a commission to an unrelated importer, that commission will be deducted from the invoice price before the comparison to trigger prices is made. When a foreign seller pays a commission to a related importer, if the resale price information is available at the time of entry, that commission will be disregarded. If the resale price is not known at the time of entry, the commission will be deducted as though the sale were to an unrelated importer. Inland freight charges in the United States must also be specifically identified so that, if borne by the exporter, they may be deducted from the invoice price to permit comparison with trigger prices.

To permit adequate distribution of the new forms, the revised SSSI must be presented at the time of entry for each shipment of a steel mill product exported on or after May 7. Notice of this action will appear in the Federal Register of March 7, 1979.

For further information, contact Frank Brennan, Office of Operations, U. S. Customs Service, Washington, D. C. 20229, (202/566-8235) or Michael Gadbaw, Office of the General Counsel, Department of the Treasury, Washington, D. C. 20220, (202/566-2263).

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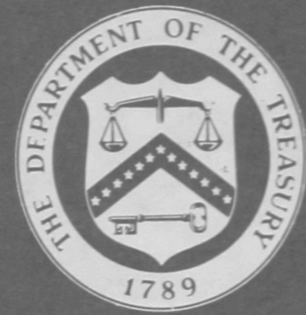

FOR IMMEDIATE RELEASE
March 1, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT ANNOUNCES
COUNTERVAILING DUTY INVESTIGATION
ON IMPORTS OF FERROALLOYS FROM SPAIN

The Treasury Department has started an investigation into whether imports of ferroalloys from Spain are being subsidized.

A preliminary determination in this case must be made by June 12, 1979, and a final determination by December 12, 1979.

Imports of ferroalloys from Spain during the period January-September 1978 were valued at about $8-million.

The investigation follows receipt of a petition alleging that manufacturers and/or exporters of this merchandise receive benefits from the Government of Spain.

The Countervailing Duty Law requires the Secretary of the Treasury to collect an additional customs duty equal to the subsidy paid on merchandise exported to the United States.

Notice of this investigation will be published in the Federal Register of March 6, 1979.

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B-1437

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

FOR IMMEDIATE RELEASE
March 2, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY REQUIRES PAYMENT OF INTEREST ON BLOCKED ACCOUNTS

The Treasury Department's Office of Foreign Assets Control today announced that publication of regulations requiring that bank deposits and certain other funds blocked under its regulations be held in interest-bearing accounts.

The regulations, published in the Federal Register of March 2, 1979, are amendments to the Foreign Assets Control Regulations, the Cuban Assets Control Regulations, and the Foreign Funds Control Regulations. Affected parties will have 30 days in which to comply.

The new requirement affects blocked accounts in the United States of the People's Republic of China, Vietnam, Cambodia, North Korea, and Cuba, and certain limited categories of assets that have been in a blocked status since World War II. Reports on the affected accounts will be required to be filed within 90 days after the publication in the Federal Register of a notice of availability of the reporting form.

The purpose of the amendments is to preserve and enhance the value of blocked assets. The assets are being held in blocked status pending possible negotiations and settlement of claims with the countries involved.

These amendments were prepared in consultation with the Department of State. They are an administrative measure applying to all blocked assets and do not represent any change in U. S. foreign policy.

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B-1438

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

FOR RELEASE ON DELIVERY

STATEMENT OF PAUL H. TAYLOR
FISCAL ASSISTANT SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON
DOMESTIC MONETARY POLICY OF THE
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
MONDAY, MARCH 5, 1979, 8:30 A.M.

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to comment on proposed legislation, H.R. 2281, to extend for five years, through April 30, 1984, the authority of Federal Reserve banks to purchase directly from the Treasury up to $5 billion of public debt obligations. Under current legislation, Public Law 95-534, approved October 27, 1978, the authority will expire at the end of next month.

The authority has existed since 1942, and has generally been extended for two-year periods, although there have been some lapses in recent years. In the last Congress the Department submitted proposed legislation to extend the direct-purchase option to October 31, 1981. Your Committee, however, suggested a one-year extension with the view to holding oversight hearings on the authority. While those hearings were

conducted on June 27, 1978, the Committee bill was not enacted into law until the fall--providing the Department, in effect, with a six-month extension. The approval of a five-year extension would provide clear recognition of the noncontroversial nature of this backstop to the Treasury's cash management responsibilities.

The primary purpose of the authority, as stated, is to serve as a backstop for Treasury cash and debt operations, permitting more effective and efficient management of our cash and credit reserves and allowing us to target lower than otherwise required cash balances in our demand accounts with Federal Reserve banks.

There have been observations made that the authority has not been used frequently in recent years and therefore the need for its continuance may have diminished. We acknowledge that the lapse of the authority on a number of occasions in recent years has prompted the Treasury to design cash management bill financing techniques which afford a considerable shortening of the time needed for raising significant sums of money. However, the value of the direct borrowing authority from the Fed does not rest on the frequency or extensiveness of its use or on its relation to other Treasury cash and credit initiatives, but rather rests on its availability as an emergency backstop for Treasury cash needs, by assuring our ability to obtain needed funds almost instantaneously in the

event of any kind of unpredictable or unanticipated financial emergency, such as unexpected cash drains or unexpected interruption of cash inflows.

The Treasury normally makes allowance in its cash and debt management planning for relatively minor financial emergencies. This is possible only because the Treasury has adequate recourse to short-term funds through our regular weekly bill issuances and the aforementioned cash management bills, which can provide funds to the Treasury in as few as three days. As a result of these instruments, from the close of calendar year 1975 to the present, we have made only a single use of the direct Fed borrowing option. (The accompanying table shows the instances of actual use since 1942.) Despite the quick cash-raising techniques developed by Treasury and the related lack of usage of the authority in the past few years, we are still convinced that we need the Fed borrowing authority, which provides for almost instantaneous or "same day" availability of funds in the case of extreme financial emergencies.

At this point, I would also like to point out that any borrowing under the Fed authority is subject to the public debt limit, is promptly reported in the Daily Treasury Statement of cash and debt operations, is also publicly reported in a weekly Federal Reserve statement, and in the Federal Reserve Board's Report to the Congress.

The Subcommittee has requested the Department to comment on a bill, H.R. 421, which would provide a substitute source of short-term funds for the Treasury by a modification of the present authority. The bill, sponsored by Congressman Hansen, would amend Section 14 of the Federal Reserve Act to authorize the Federal Reserve banks to lend securities held in the Federal Reserve's portfolio of investments to the Secretary of the Treasury for the latter's sale of such obligations in the market. The Secretary would be required to repurchase any such obligations sold in the market and return them to the Federal Reserve bank within six months of sale date. The present direct purchase authority would be repealed under the provisions of H.R. 421.

The methodology provided in H.R. 421 would be cumbersome from the standpoint of Treasury's fiscal operations and would not provide for immediate funding of emergency cash needs since market sales of such securities in any significant size would have to be accomplished by early afternoon of any particular day in order to avoid undue disruption to the market. This contrasts to the practice under the current authority of accomplishing the Fed borrowing at any time prior to the closing of the transcripts of activity in the accounts for the day.

Thus, the bill would not meet the Treasury's need for a back-stop in the form of immediately available funds.

We understand that the intent of H.R. 421 is to assure that Treasury borrowing activity is subject to market forces. I would like to reiterate Treasury's past testimony that we would not attempt, through the direct-purchase option, to influence credit conditions or otherwise avoid the discipline of the marketplace. Our policy has been and continues to be that our debt obligations should be offered directly in the market and that purchases of Treasury obligations by the Federal Reserve should normally be made through that same market.

H.R. 421 also raises a number of broader questions from the standpoint of Treasury debt management policy and possible adverse effects on the market for Treasury securities. We would like to submit further comments on these aspects of the bill, and I expect that the Federal Reserve representatives' comments on the bill will address the implications for open market operations.

In conclusion, I would summarize the Treasury position as favoring a five-year extension of the present authority. Mr. Chairman, the Department views the authority as a temporary accommodation to be used only under the most unusual

financial circumstances. We believe that adequate controls exist for its use, since it is fully disclosed and is subject to the discretion and control of the Federal Reserve itself; and that the authority is too important as a cash management tool to be permitted to periodically lapse because of erratic extensions. Therefore, we urge prompt consideration of H.R. 2281 to assure continuity of this authority through April 30, 1984.

That concludes my prepared statement, Mr. Chairman. I will be glad to respond to any questions.

Attachment

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DIRECT BORROWING FROM FEDERAL RESERVE BANKS 1942 TO DATE

Calendar Year	Days Used	Maximum Amount At Any Time (Millions)	Number of Separate Times Used	Maximum Number Of Days Used At Any One Time
1942	19	$ 422	4	6
1943	48	1,302	4	28
1944	none	--	-	-
1945	9	484	2	7
1946	none	--	-	-
1947	none	--	-	-
1948	none	--	-	-
1949	2	220	1	2
1950	2	180	2	1
1951	4	320	2	2
1952	30	811	4	9
1953	29	1,172	2	20
1954	15	424	2	13
1955	none	--	-	-
1956	none	--	-	-
1957	none	--	-	-
1958	2	207	1	2
1959	none	--	-	-
1960	none	--	-	-
1961	none	--	-	-
1962	none	--	-	-
1963	none	--	-	-
1964	none	--	-	-
1965	none	--	-	-
1966	3	169	1	3
1967	7	153	3	3
1968	8	596	3	6
1969	21	1,102	2	12
1970	none	--	-	-
1971	9	610	1	7
1972	1	38	1	1
1973	10	485	3	6
1974	1	131	1	1
1975	16	1,042	4	7
1976	none	--	-	-
1977	4	2,500	1	4
1978	none	--	-	-
1979	none	--	-	-

Note: Federal Reserve direct purchase authority expired on April 30, 1978, and was renewed through April 30, 1979 by P.L. 95-534, approved Ocotber 27, 1978

Office of the Fiscal Assistant Secretary March 1, 1979

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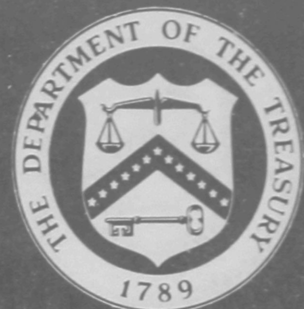

FOR IMMEDIATE RELEASE

March 5, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,900 million of 13-week Treasury bills and for $3,000 million of 26-week Treasury bills, both series to be issued on March 8, 1979, 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 7, 1979			26-week bills maturing September 6, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.642	9.328%	9.71%	95.245 a/	9.405%	10.04%
Low	97.626	9.392%	9.78%	95.237	9.421%	10.06%
Average	97.633	9.364%	9.75%	95.240	9.415%	10.05%

Excepting 1 tender of $25,000

Tenders at the low price for the 13-week bills were allotted 6%.
Tenders at the low price for the 26-week bills were allotted 99%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 3,870,000	$ 3,870,000	$ 24,360,000	$ 13,360,000
New York	4,321,775,000	2,528,275,000	4,895,110,000	2,730,925,000
Philadelphia	21,335,000	21,335,000	9,915,000	9,915,000
Cleveland	30,850,000	29,850,000	59,125,000	18,125,000
Richmond	24,840,000	24,040,000	32,610,000	32,610,000
Atlanta	34,690,000	34,690,000	21,295,000	21,295,000
Chicago	215,630,000	72,630,000	219,940,000	33,440,000
St. Louis	42,510,000	17,630,000	39,965,000	12,965,000
Minneapolis	14,185,000	14,185,000	11,390,000	11,360,000
Kansas City	23,880,000	21,880,000	16,895,000	16,895,000
Dallas	16,510,000	16,510,000	8,700,000	8,680,000
San Francisco	301,720,000	101,720,000	325,700,000	78,700,000
Treasury	13,565,000	13,565,000	11,860,000	11,860,000
TOTALS	$5,065,360,000	$2,900,180,000 b/	$5,676,865,000	$3,000,130,000 c/

Includes $402,315,000 noncompetitive tenders from the public.
Includes $231,900,000 noncompetitive tenders from the public.
Equivalent coupon-issue yield.

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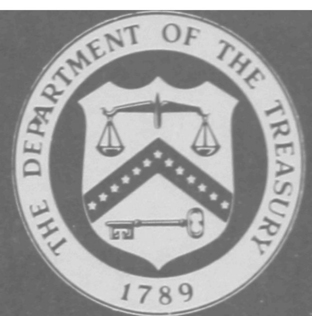

FOR RELEASE ON DELIVERY
EXPECTED AT 2:00 P.M.
March 6, 1979

STATEMENT BY
THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE HOUSE SUBCOMMITTEE ON APPROPRIATIONS

Mr. Chairman and Members of this distinguished Subcommittee:

I am pleased to be here with you to discuss the Department of the Treasury's budget request for FY 1980. I will present an overview of that budget for the Secretary who is unavailable for this hearing. He will appear before this subcommittee later this month to discuss the state of the economy and the Administration's economic policy. I will only briefly touch on those matters here today.

ECONOMIC POLICY

The American economy has enjoyed an unprecedented recovery of employment and production since the recession of 1974-1975, but these achievements now stand threatened by inflation. Unless we assure the integrity of our currency, both at home and abroad, the economy's forward progress will reach the dead-end of recession and financial turmoil.

Our fundamental economic problem is inflation. Over the 1970's, inflation has posed a critical threat to economic progress throughout North America, Europe, and Japan. It has made all of our other problems much worse. More than once, it has seriously shaken the international monetary system. Everywhere it has retarded economic growth and social progress. There is no one cause for the problem, and we cannot expect to solve it either quickly or with any single panacea.

In the spring of last year, the President moved the fight against inflation ahead of all other objectives and initiated what has become a succession of actions designed to slow the rate of inflation.

B-1441

During the spring and summer of 1978, the President worked with the Congress to reduce the FY 1979 budget deficit to less than $38 billion. In late October, the President set a target of $30 billion or less for the FY 1980 budget deficit and announced voluntary wage-price standards, supported by an innovative plan for real wage insurance to encourage compliance with the wage standard, along with a new procedure for review of federal regulations. On November 1, the Federal Reserve Board tightened credit expansion and the President simultaneously announced new arrangements with Germany, Japan, and Switzerland to stabilize and strengthen the dollar in the foreign exchange markets.

Parts of the program have achieved limited success, but reversing a decade of creeping inflation requires a long-term commitment by the entire Federal Government, supported by all sectors of our economy.

If we show the requisite discipline, we continue to believe our economy can be successfully steered, without a recession, on to a path of price stability and steadily enlarging prosperity.

A key to the containment and reversal of inflation is the successful structuring by the Executive Branch and the Congress of a fiscally responsible budget for 1980. That means slowing the rate of increase in federal expenditures and that necessarily means austerity in the Treasury budget even though it is not among the major segments of the overall budget.

FISCAL YEAR 1980 BUDGET

Since the heads of Treasury bureaus have already testified in detail on their appropriation requests, I will present an overview and brief description of our proposed budget for 1980 and also provide as an addendum to this statement summaries of each bureau's request.

The budget reflects our continued effort to arrive at resource levels that will permit us to achieve a proper balance between fulfilling our traditional operating responsibilities, while at the same time facilitating our policy role in the financial and economic affairs of the nation.

Our policy responsibilities on the domestic and international side are heavy and growing. The cross-currents of events affecting the domestic and international economies have added greatly to our responsibilities in formulating financial and tax policy. Our participation in the formulation of broad fiscal policies that have significant affect on the economy, and in managing the public debt, contribute to this increased workload.

On the operational side, our principal activities continue to center on the processing of tax returns, clearing people and merchandise through Customs, servicing public debt securities, issuing Government checks and manufacturing coins, currency and stamps, and carrying out numerous and diverse law enforcement and regulatory responsibilities. This basic workload continues to increase and so must our resources, although we have been able to hold down the size of our increases by capturing the benefits of productivity improvements. Our revenue-producing bureaus expect to collect receipts of $467 billion in 1980, compared to $425 billion in 1979. This represents over 90 percent of the Government's total receipts. We will issue 726 million checks from our disbursing centers which is 24 million more than in 1979. We plan to produce 15 billion coins, a 15 percent increase over 1979, including 565 million Susan B. Anthony dollar coins; we will issue, service and redeem 293 million bonds and securities and introduce a new EE and HH series of savings bonds to replace the existing E and H series; we will process around 137 million tax returns, a 2 percent increase over the previous fiscal year; and we will process 300 million or more arriving persons and 4 million formal Customs entries, increases of 4 percent and 7 percent respectively. In addition to these increased workload requirements, resources are also needed for our other high priority objectives, primarily to protect candidates and nominees during the 1980 Presidential Campaign and to modestly strengthen and improve a small number of program areas.

In March of last year, the Department proposed certain regulations pertaining to firearms. It should be noted that no funds are being requested in this budget to implement those, or alternative, regulations. A notice that the proposals have been withdrawn was recently published in the Federal Register.

Resources Requested

The Department is requesting $3.4 billion for its fiscal year 1980 operating appropriations. This is a decrease of $456 million from the proposed authorized level for fiscal year 1979 -- the original appropriation plus pending supplementals. The large reduction compared to 1979 is the net of program increases of $45 million, price and other mandatory increases for the maintenance of current levels of $138 million, and non-recurring costs and savings of $639 million. The sizable non-recurring costs result primarily from a one-time payment in 1979 of $543 million to states by the Bureau of Government Financial Operations

for social service program claims. Table I shows the appropriation amounts requested for each bureau and the changes compared to 1979. Table II shows the positions related to the 1980 funding request. We are asking for 116,717 total positions, a decrease of 539 compared to 1979. Table III shows the starting point from which 1980 amounts are more properly compared.

Program Increases for Workload

To meet workload increases, we are requesting an additional $19.5 million over fiscal year 1979. The Internal Revenue Service will need $16.2 million of the amount to keep pace with its normal workload increases. Most of this amount is for the processing of additional tax returns. No program increases are proposed for the Service's other principal functions of audit, collection, taxpayer service and fraud investigations. This will necessitate a slight overall decrease in the level of the audit and taxpayer service programs in 1980.

We are requesting an additional $1.7 million for the issuing of an additional 23.8 million checks and the processing of related claims by the Bureau of Government Financial Operations, and another $.8 million for the Bureau of the Mint to produce an additional two billion coins. In addition, we are asking for an additional $.6 million for program workload increases within the Office of the Secretary and $.2 million for higher costs associated with the issuing and redeeming of government securities by the Bureau of the Public Debt.

Program Improvements

We are requesting an increase of $25.7 million for program improvements. This represents less than 1 percent of our proposed authorized level for 1979.

The largest item in this increase is $16 million for the United States Secret Service to carry out its responsibilities for the protection of candidates and nominees during the 1980 Presidential Campaign. The preponderance of the funds are required for the extensive travel of agents, overtime, services acquired from other agencies and equipment. These funding resources will enable the Secret Service to begin protective coverage on March 1, 1980. The Service is also requesting an additional $.7 million to keep abreast of changes in technology in order to assure technically secure environments for their protectees.

The Customs Service is requesting an additional $3.4 million for enforcement and processing programs. In the area of interdiction, the Service is planning the continued development and acquisition of narcotics vapor detection systems at a cost of $1 million. These funds would permit additional development and research on the most potentially useful devices for a variety of applications that are effective in situations

involving both arriving passengers and containerized cargo. An additional $.8 million would be used for development of enforcement systems technologies that will assist the Service in the detection of a wide range of contraband. We are also requesting $.1 million to establish two new ports-of-entry in 1980. Finally, $1.6 million is requested to interface the Customs mail processing operation at new facilities at the John F. Kennedy International Airport with those of the Postal Service, and to provide for a slight increase in regulatory audit. The funds for the JFK mail facility will reduce the transshipment time between Customs ports and postal facilities for international mail, thereby improving service to the public and reducing costs to Customs as well as the Postal Service.

The Bureau of Government Financial Operations is requesting an additional $1.1 million for the acquisition of automatic data processing equipment to replace aged and obsolete computer systems used in their check processing operations, an additional $.4 million for improved program management, and $.2 million for the Payment of Government Losses in Shipment fund.

The Bureau of the Mint request is for an increase of $1.3 million to terminate refining operations at the New York Assay Office should on-going studies indicate that contracting out with the private sector is more cost-effective than present operations, and $.2 million for the purchase of additional coining presses. The Assay Office studies are expected to be completed later this spring. We appreciate the many helpful comments we have received from the Congress, and we will of course consider them fully. I am pleased to report that as a result of the study conducted last year by a Treasury Task Force, productivity is up at the New York Assay Office.

The Bureau of the Public Debt is requesting an additional $1.5 million for the procurement and promotion of the new EE and HH series savings bonds. Of this amount, $.7 million is for the new bond stock which must be printed and distributed to some 40,000 issuing agents and $.8 million is for materials to be used in the campaign to introduce the new bonds.

The Bureau of Alcohol, Tobacco and Firearms is requesting an additional $.4 million for investigative, technical and scientific equipment.

For the International Affairs appropriation, an additional $.4 million is requested to improve the data gathering capability and analysis necessary to support Treasury international policy decisions, and provide for conduct of the Foreign Portfolio Investment Survey directed by the Congress last year.

Maintenance of Current Operating Levels

The cost of maintaining in fiscal year 1980 the programs now underway, or expected to be underway in fiscal year 1979, constitutes the last category of major costs in our 1980 request. In 1980, these costs reflect a decrease of $501.3 million, primarily because of the $543 million in non-recurring costs on payments made in 1979 by the Bureau of Government Financial Operations to states on social service program claims. Specifically, the $501.3 million decrease is the net of the following: price and other mandatory increases, $138.0 million; less non-recurring cost of one-time payments to states, $543.0 million; less other non-recurring costs, savings and program reductions, $96.3 million.

Nearly 60 percent of the $138.0 million for price and other mandatory increases is needed for the full-year cost of programs and pay increases authorized in 1979, and for two additional workdays in 1980. The principal remaining increases reflect the increased cost of printing, within-grade promotions required by law, support services, communications, postage, grade-to-grade promotions, and General Services Administration space rentals.

Program reductions, along with productivity and other management savings, amount to $56.6 million of the $96.3 million in reductions the Department intends to achieve in 1980 and are reflective in our desire to restrain growth in Federal expenditures.

This completes my statement on the 1980 budget. I shall be glad to respond to any questions.

Table I

THE DEPARTMENT OF THE TREASURY

Operating Accounts Appropriations for
Treasury Department for 1979
and Estimated Requirements for 1980
(in millions of dollars)

	1979 Proposed Authorized Level[1]	1980 Budget Estimate	Increase or Decrease (-) Compared to 1979
Regular Operating Appropriations:			
Office of the Secretary	$ 31.0	$ 30.8	$ -.2
International Affairs	5.5	22.8	17.3
Federal Law Enforcement Training Center	15.0	12.7	-2.3
Bureau of Government Financial Operations:			
Salaries and Expenses	728.3	191.1	-537.2
Government Losses in Shipment	---	.2	.2
Payments to Guam	.2	---	-.2
Bureau of Alcohol, Tobacco & Firearms	137.9	139.0	1.1
U.S. Customs Service	442.9	446.9	4.0
Bureau of Engraving & Printing	---	---	---
Bureau of the Mint	46.0	50.6	4.6
Bureau of the Public Debt	171.0	183.4	12.4
Internal Revenue Service:			
Salaries and Expenses	142.2	142.9	.7
Taxpayer Service & Returns Processing	754.1	773.2	19.1
Examinations and Appeals	780.3	789.7	9.4
Investigations and Collections	478.7	476.7	-2.0
TOTAL, IRS	$2.155.3	$2.182.5	27.2
U.S. Secret Service	140.0	157.0	17.0
TOTAL, Regular Operating Appropriations	$3,873.1	$3.417.0	$-456.1

[1] Includes pay increases authorized by E.O., effective October 1, 1978, and program supplementals for the Bureau of Government Financial Operations, ($9.0); AT&F, ($1.7); U.S. Customs, ($2.8); Mint, ($2.4); IRS, ($39.5); and Secret Service ($.7); and International Affairs ($5.4). It also includes transfers from the Office of the Secretary ($-1.3); and IRS ($-.2).

Table II

THE DEPARTMENT OF THE TREASURY

Operating Accounts
Comparative Statement of Average Positions
Fiscal Year 1979 and 1980
(Direct Appropriations Only)

	Proposed 1979 Authorized Level	1980 Budget Estimate	Increase or Decrease (-) Compared to 1979
Regular Annual Operating Appropriations:			
Office of the Secretary	803	794	-9
International Affairs	123(509) 1/	491	368(-18)
Federal Law Enforcement Training Center	297	249	-48
Bureau of Government Financial Operations	2,730	2,750	20
Bureau of Alcohol, Tobacco & Firearms	3,928	3,786	-142
U.S. Customs Service	14,027	13,618	-409
Bureau of the Mint	1,667	1,703	36
Bureau of the Public Debt	2,639	2,572	-67
Internal Revenue Service:			
Salaries and Expenses	4,638	4,516	-122
Taxpayer Service & Returns Processing	34,576	35,235	659
Examinations and Appeals	29,805	29,551	-254
Investigation and Collections	18,444	17,927	-517
TOTAL, IRS	87,463	87,229	-234
U.S. Secret Service	3,579	3,525	-54
TOTAL, Regular Annual Operating Appropriations	117,256 (117,642)	116,717	-539 (-925)

1/ Reflects average positions for the full year. The 123 average positions reflect requirements for three months.

Table III

THE DEPARTMENT OF THE TREASURY
Derivation of "Proposed Authorized Level for 1979"
(in thousands of dollars)

1979 Appropriation (adjusted by transfers)		$3,730,977
Proposed Supplementals		
1. Pay Increase		
a) Classified	$80,348	
b) Wage Board	179	+ 80,527
2. Program Increases:		
a) International Affairs - to fund for 3 months in 1979 the international activities previously paid by the Exchange Stabilization fund	$ 5,442	
b) Government Financial Operations - increased cost of postage	9,017	
c) Alcohol, Tobacco and Firearms - to combat interstate cigarette smuggling as authorized by Public Law 95-575	1,700	
d) Customs Service - to fund the cost of collecting duties in Virgin Islands which was previously paid by the Virgin Islands	2,848	
e) Mint - to provide funds to mint the new one-dollar coin	2,381	
f) Internal Revenue Service - to provide funds to implement the Revenue Act of 1978 and the Energy Act of 1978	39,517	
g) Secret Service - to provide for the increase cost of protective travel	700	+61,605
Proposed Authorized Level for 1979		$3,873,109

Summary Analysis of FY 1980 Estimates for Operating Bureaus and Offices

Office of the Secretary - $30,850,000

-- Net decrease is $178,000 and 9 average positions of employment.

-- $560,000 and 9 average positions are needed for increased workload.

-- $858,000 and 1 average position is needed to maintain current levels of operations -- within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $1,596,000 and 18 average positions is principally for non-recurring one-time costs and productivity savings.

International Affairs - $22,752,000

-- Net increase is $17,310,000 and 368 average positions of employment.

-- $407,000 is required for economic policy.

-- $17,627,000 is provided to maintain current levels of operation, of which $16,948,000 is for full-year funding in 1980 for the International Affairs activity.

-- A reduction of $724,000 is for productivity savings.

Federal Law Enforcement Training Center - $12,670,000 for Salaries and Expenses

-- Net decrease for Salaries and Expenses of $2,330,000 and 48 average positions of employment.

-- An increase of $825,000 is for the costs related to maintaining current levels of operations -- within-grade promotions, annualization of pay increases, etc.

-- A reduction of $100,000 is for productivity savings.

-- A reduction of $3,055,000 for reduction in student pipeline from 650 to 525.

Bureau of Government Financial Operations - $191,115,000 for Salaries and Expenses, $200,000 for Government Losses in Shipment, -0- for Payments to Guam

(GFO continued)

-- Net decrease for salaries and expenses is $537,191,000 and an increase of 20 average positions of employment.

-- $1,726,000 and 5 average positions are for added workload in the check issuance area.

-- $1,149,000 is to provide for ADP and capital equipment acquisitions.

-- $410,000 and 22 average positions are for improved management in the bureau.

-- $7,176,000 is required to maintain current staff levels -- within-grades, space rental, annualization of postage increases and full-year costs of programs authorized for part of 1979.

-- Reductions of $547,652,000 and 7 average positions for management savings and non-recurring one-time costs, the majority of which relates to a one-time payment in 1979 for claims.

Bureau of Alcohol, Tobacco and Firearms - $139,000,000

-- A net increase of $1,078,000 and a reduction of 142 average positions of employment.

-- $416,000 is required for the replacement of equipment.

-- $6,323,000 is for costs to maintain current levels of operations, which include such items as within-grade promotions, grade to grade promotions, and increased printing, postage, and space costs.

-- A reduction of $5,661,000 and 142 average positions for program reductions and non-recurring costs and savings.

U.S. Customs Service - $446,857,000

-- Net increase of $4,000,000 and a reduction of 409 average positions of employment.

-- $1,000,000 is for narcotics detection devices used in inspection and control.

-- $750,000 and 2 average positions are for enforcement systems development primarily in the interdiction area.

-- $1,448,000 is for payments to the Postal Service for the new JFK Mail Facility.

(Customs continued)

-- $239,000 and 10 average positions for new ports of entry ($96,000) and regulatory audit ($143,000).

-- An increase of $13,283,000 and 161 average positions are to maintain current levels of operation -- within-grade promotions, grade to grade promotions, price increases, annualization of pay increases, space increases, etc.

-- A reduction of $12,720,000 and 582 average positions are for non-recurring costs and savings, productivity savings, and program reductions.

Bureau of the Mint - $50,580,000 for Salaries and Expenses

-- Net increase for Salaries and Expenses, $4,615,000 and 36 average positions.

-- $825,000 and 37 average positions are for increased workload.

-- $1,300,000 is for termination of the facility for the refining of gold.

-- $4,349,000 and 6 average positions are required to maintain current levels of operations -- within-grade promotions, annualization of pay increases, FTS costs, etc.

-- $200,000 is required for other program increases.

-- A reduction of $2,059,000 and 7 average positions is for non-recurring costs and savings and program reductions.

Bureau of the Public Debt - $183,466,000

-- An increase of $12,466,000 and a reduction of 67 average positions of employment.

-- $226,000 is for reimbursement to paying agents for redemptions and reimbursements to disbursing centers for reissuance of savings bonds.

-- $1,452,000 is to provide for a new savings bond.

-- $14,123,000 to maintain current levels of operations, including such major items as within-grade promotions, annualization of pay increases, space rental costs, annualization of postage, and full-year cost of the Treasury Tax and Loan Accounts ($11,289,000).

(Public Debt continued)

-- A reduction of $3,335,000 and 67 average positions for non-recurring costs, and management savings.

Internal Revenue Service - $2,182,490,000

Salaries and Expenses - $142,908,000

-- A net increase of $714,000 and a reduction of 122 average positions of employment.

-- $500,000 is for productivity enhancing investments.

-- $2,635,000 and 14 average positions are to maintain current levels of operations -- within-grade promotions annualization of pay increases, space rental costs, etc.

-- A reduction of $2,421,000 and 136 average positions covering non-recurring costs and savings and program reductions.

Taxpayer Service and Returns Processing - $773,160,000

-- A net increase of $19,082,000 and 659 average positions of employment.

-- $12,970,000 and 603 average positions are for processing additional tax returns.

-- $2,686,000 is for productivity enhancing investments to improve tax administration.

-- $28,818,000 and 393 average positions to maintain current levels of operation -- within-grade promotions, grade to grade promotions, space rental costs, annualization of pay increases and programs authorized for part of FY 1979, etc.

-- A reduction of $25,392,000 and 337 average positions covering non-recurring costs and savings and program reductions.

Examinations and Appeals - $789,711,000

-- A net increase of $9,381,000 and a reduction of 254 average positions of employment.

-- An increase of $29,342,000 and 197 average positions are to maintain current levels of operations including such items as within-grade promotions, grade to grade promotions, annualization of pay increases, etc.

(IRS: Examinations and Appeals continued)

-- A reduction of $19,961,000 and 451 average positions is for non-recurring costs and savings and program reductions.

Investigation and Collection - $476,711,000

-- Net decrease of $2,032,000 and 517 average positions of employment.

-- An increase of $8,797,000 and 28 average positions is to maintain current levels of operations including such items as within-grade promotions, grade to grade promotions, annualization of pay raises, etc.

-- A reduction of $10,829,000 and 545 average positions is for non-recurring costs and savings and program reductions.

U.S. Secret Service - $157,000,000

-- Net increase is $16,972,000 and a reduction of 54 average positions of employment.

-- $16,000,000 is required for protection of all major candidates in the 1980 Presidential election.

-- $659,000 is for technical security equipment.

-- $85,000 is to provide for new ADP equipment.

-- $3,812,000 is for those costs required to maintain current levels of operation -- within-grade promotions, grade to grade promotions, annualization of pay, space rental, etc.

-- A reduction of $3,584,000 and 54 average positions is for non-recurring equipment costs and program reductions.

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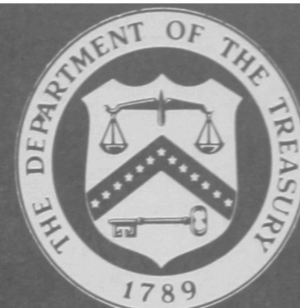
WASHINGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE
UPON DELIVERY
EXPECTED AT 10:00 A.M.
TUESDAY, MARCH 6, 1979

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE COMMITTEE ON BANKING, HOUSING,
AND URBAN AFFAIRS

It is a pleasure for me to testify before this Committee on U.S. export control policy and the Export Administration Act. I will focus my comments this morning on the economic issues involving the potential use of export controls, and more specifically the question of controls on U.S. technology exports raised by the Chairman. I will also address the related issue of foreign government intervention into technology transfer and U.S. policy in this area.

Economic Considerations

Export controls, regardless of the reason for their imposition, are undesirable on purely economic grounds for a number of reasons.

As you are well aware, the United States is currently suffering a substantial deficit in its balance of trade. I will not discuss the causes of the deficit in detail with you today. But it is clear that we must act to rectify that imbalance, and that increasing U.S. exports is the most constructive way to achieve that goal.

Last September, the President announced a comprehensive program to encourage U.S. exports. In his statement, the President declared that "it is important for this Nation's economic vitality that both the private sector and the Federal government place a higher priority on exports". If we are to increase exports sufficiently to correct our trade imbalance, we must evaluate carefully any contemplated export controls.

Political and security goals may, at times, conflict with purely economic goals. But we must pay greater attention to the purely economic drawbacks of controls, especially in view of our current trade position. We must never forget that a strong trade position, a strong dollar and a stable international monetary system -- which requires a stable dollar -- are also crucial to the foreign policy and national security of the United States.

In imposing export controls on a product, we are not simply losing foreign exchange earnings on that product. There are cumulative long-range negative repercussions as well.

First, export restrictions call into question the reliability of the United States as a supplier of products to other countries. Those countries are likely to develop alternative sources for a controlled product. They may also develop alternative sources, or substitutes, for other products which they import from the controlling country and which they fear may be subjected to controls as well.

One clear example is soybeans. The main effect of the U.S. controls over soybeans exports in 1974 was not a reduction of inflation in the United States. It was to induce Japan to turn to other sources, particularly Brazil, for soybeans and to invest huge amounts to develop alternatives to U.S. production. Few U.S. policies in recent memory have represented such folly.

Second, imposition of export controls by one country can trigger emulation and successive waves of retaliation by other affected countries, and thus hurt the long-run economic interests of the country that originally imposed controls. Even the United States, which produces a wide range of primary and manufactured products, is dependent on imports for a number of key products. The U.S. export controls on soybeans and other products in 1973-74 clearly added to the legitimacy of such action by those who applied similar controls to oil and other products soon thereafter.

Widespread use of export controls could in fact parallel the widespread use of import controls in the 1930's, with potentially disruptive implications for the world economy. It is obvious that no one is now contemplating any such extensive use of export controls, but it is well to remember that even seemingly small steps in this direction -- like seemingly small steps to apply import controls -- can have very far-reaching consequences for U.S. economic and political interests.

We do see one exception to the general rule that export controls are undesirable on economic grounds. Controls over either exports or imports can be an appropriate measure if they are used as a lever to gain access for U.S. products to foreign markets which are unfairly restricting entry of U.S. exports. Alternatively, they can be used against countries which are restricting exports of commodities to the United States.

Control of Export of Technology

I have dealt so far largely with export controls applied for reasons of "short supply," but the Chairman has raised a number of questions concerning the use of such controls vis-a-vis technology transfer.

The Export Administration Act of 1969, as amended, provides specifically for the use of controls on the export of "goods and technology which would make a significant contribution to the military potential of any other nation or nations which would prove detrimental to the national security of the United States." There has been some concern expressed that controls should also be placed on the export of commercial technology in order to maximize U.S. competitiveness in international markets. Proponents argue that transfer of commercial technology has cost the United States economy both exports and jobs.

Controls on exports of commercial technology clearly would be contrary to our traditional policy of seeking to

minimize the barriers to the international movement of goods, services and capital. But on a more pragmatic level, I think there are also several considerations which raise considerable doubts about the utility of any such restrictions:

(1) It is justifiable even in principle to restrict exports of technology if and only if U.S. firms possess uniquely the technology and all readily substitutable technologies. If foreign producers hold equivalent or substitutable technologies, U.S. exporters will simply lose business to foreigners.

(2) Technology is easily replicated and patents provide only limited protection against such replication. Therefore, any control would be effective only for a limited time.

(3) Private business firms invest in the development of new technologies only if they expect to earn a return on this investment. Multinational firms which perform a high percentage of total U.S. industrial research and development, obtain, on average, more than one third of their returns from the use or sale of the technology in foreign markets. Restraint on the export of technology would create a clear disincentive for investment in new technology, with a consequent loss of potential future benefits to the U.S. economy and U.S. competitiveness.

(4) In some cases U.S. firms have begun to license, sell, or otherwise transfer overseas recently developed

technologies in advance of competitive development of technologies elsewhere, but we believe these represent only a tiny minority of all cases of technology transfer. While it might in principle be in the national interest to identify and stop such cases of premature technology transfer, we doubt whether it would be possible to administer such a program in a manner which doesn't make the cure worse than the disease. While we may be able in theory to identify certain exports of technology which would not be in the national interest, to identify such cases in actual practice is another matter.

(5) Finally, contrary to what some would have us believe, U.S. exports of manufactured goods embodying advanced technologies have consistently exceeded U.S. imports of similar goods throughout the past decade. (See Table 1). Although the balance of trade in these goods declined slightly from 1975 through 1977, the surplus remained impressively high (at almost $14 billion in 1977) and we expect that the data for 1978 will show a reversal of this trend and a still higher surplus.

Indeed, U.S. exports of technology-intensive manufactured goods have been a source of strength in our balance of payments at a time when the overall picture has often been less than encouraging. In response to further economic growth abroad and recent exchange rate changes, U.S. exports of all

manufactured goods, including high technology goods, should grow faster in the coming years than U.S. imports.

U.S. performance in export of technology intensive goods remains strong because the United States remains by far the most important performer of industrial research and development (R&D), exceeding the combined R&D of Japan, West Germany, Canada, the United Kingdom, and France -- whose combined GNP is slightly more than that of the United States. (See Tables 2 and 3) U.S. research and development expenditures as a percent of GNP exceed those of all major Western nations except West Germany, whose proportionate expenditures are equivalent to ours. While U.S. proportionate expenditures have declined somewhat since their peak in the early 1960's, due to the winding down of the U.S. space program, since 1973 they have been fairly constant. (Chart 1)

Chart 1 also shows that expenditures on R&D as a percent of GNP have risen since the 1960's in West Germany and Japan, with most of the increase occurring during the late 1960's and early 1970's. In recent years, proportionate expenditures on R&D in these two nations have been almost constant, while in France, Canada, and the United Kingdom, proportionate expenditures since the middle 1960's have fallen.

Germany, traditionally a major center of scientific and technological expertise, has actually not fully regained its pre-World War II position as a performer of R&D. Japan, which

has been adept at imitating and improving other nations' technologies, has only recently emerged as a true technological innovator in its own right.

For the future, the United States undoubtedly will continue to perform more of the world's research and development than any other nation or group of nations. To assure maximum U.S. competitiveness, our Government should support a continued high level of R&D as we have been doing: such expenditures rose by 22 percent during the past two years, and the President has proposed expenditures for FY 80 which will, in real terms, remain approximately the same as last year in spite of the overall tightness of his budget proposals. Our country will not, however, totally dominate the development of new technologies to the degree that it did during the two decades or so following the Second World War.

The increasing role of other nations in developing new technology means that they will bear more of the costs of development than was the case during the 1950's and 1960's, while the benefits of new technology will continue to be shared by all nations, including our own. We believe that this is a good thing.

In sum, I think there should continue to be a strong presumption against restricting exports of technology. Proponents of restrictions carry a heavy burden of demonstrating that it would be in the national interest to do so.

Foreign Government Intervention

I would now like to address another issue -- our concern about the use of measures by other governments which can have the effect of encouraging the transfer of technology. Such measures may take many forms, but they usually combine several basic features: direct incentives to investors to attract the transfer in the first place; performance requirements, which require firms *inter alia* to transfer technology as a condition of investing in the country at all; and offsets in major industrial or military deals. Such measures are utilized to assure that U.S. or other foreign firms do in fact contribute to the priority economic and social goals of the host government. They typically focus upon local job creation, local value-added, and exports as well as technology transfer.

In recent years, offset requirements have been most common in the area of defense procurement, where foreign governments have used their purchasing power to impose these requirements on U.S firms seeking to sell to them. Moreover, their use of offsets is quickly spreading to the non-defense area. Thus, a foreign government will frequently require that, for a U.S. firm to do business, it must agree to transfer technology to the nation by means of licensing or co-production agreements. Although inconsistent with the spirit of the GATT and the concept of

an open multilateral trade and payments system, these requirements are rapidly becoming a pervasive feature of the world economy.

These foreign government measures can result in the transfer of technology on terms that are unfavorable to our nation. Thus a major objective of U.S. policy must be to achieve multilateral discipline on incentives and other interventions, both to maintain an open investment environment and to avoid our being forced into the adoption of emulative countermeasures. With offshore output by multinational firms now approaching a value of $1 trillion, it is anomalous that no major inter-governmental agreements apply to the international investment process like the long-standing rules and institutional arrangements which govern international trade.

Some of the new international arrangements worked out in the Multilateral Trade Negotiations will, in fact, help deal with this problem by limiting the use of such incentives as export and other subsidy practices. But the development of disciplines over government policies toward investment flows per se has become one of our important areas of policy initiative. My colleagues in other agencies and I have recently discussed these problems bilaterally with Canada and our major European allies, as well as multilaterally in the OECD. Our talks with Canada, as an example, have focused on a case of what we consider to be bad policy:

a cash grant of $68 million, jointly offered by both the Canadian federal government and the provincial government of Ontario, to induce the Ford Motor Company to locate a new engine plant near Windsor, Ontario. We have also expressed concern to our other neighboring nation, Mexico, over that nation's Automobile Decrees, which require all automobile assemblers there to cover their full foreign exchange costs through exports and provide them with attractive tax credits for doing so. These kinds of policies, which are also practiced by many other nations, serve to distort the economically efficient allocation of resources and can result in the loss of U.S. export opportunities and U.S. jobs.

At the Bonn Summit last July, we joined the other participants in emphasizing our willingness to increase cooperation in the field of foreign private investment flows among industrialized countries and between industrialized and developing countries. We also stated in the Summit communique that we will intensify work for further agreements in the OECD and elsewhere. President Carter has asked the State Department, in consultation with the Departments of Defense, Treasury, Commerce, the Office of the Special Trade Representative, the Council of Economic Advisors, and the Office of Management and Budget, to consider multilateral consultations on the adverse impact of defense offset sales agreements and to seek their reduction through the formulation of internationally agreed guidelines on the

terms for future agreements. In view of the increasing importance of non-defense offsets, especially investment offsets, we at the Treasury Department believe that guidelines should also be sought for these.

The basic problem we face in trying to achieve discipline is that most governments have not yet recognized the need for international cooperation on investment, even though they long ago recognized the need for rules on trade and international monetary policy. In part, this is because direct investment and technology transfer are relatively new as major vehicles for international economic exchange, and their impact has not been as visible as the impact of trade flows and exchange rate changes. There are also ambivalent and conflicting views on the jurisdiction of the different sovereign states involved in the broad-guaged activities of multinational companies.

It is apparent, therefore, that the process of developing cooperation in this are, which has already begun, will be evolutionary in nature. It will involve gradual development rather than the creation of a complete international investment regime at a single stroke. But the need for cooperation is clear, and we intend to press vigorously to draw international attention to this area.

Treasury Responsibilities

Finally, Mr. Chairman, you asked several questions about the specific role of the Treasury Department vis-a-vis export controls.

Treasury administers controls with respect to exports from foreign countries by foreign firms owned or controlled by U.S. persons or firms. Such firms are prohibited from selling any commodities or technology to North Korea, Viet Nam, Cambodia, or Cuba without a Treasury license. Treasury regulations also prohibit the unlicensed sale of strategic goods to Eastern Europe, the U.S.S.R., and the People's Republic of China by such firms. These latter regulations apply only to strategic goods and not to technology. They are obviously an extension of the primary export controls on U.S.-based firms administered by the Department of Commerce for national security or foreign policy reasons.

Treasury also participates in interagency bodies which review export administration and make recommendations on it. The Secretary of the Treasury is a member of the Export Administration Review Board. Treasury is also represented on the Advisory Committee on Export Policy and on its Operating Committee, which considers difficult cases and makes recommendations.

Treasury has collaborated in various interagency studies seeking to improve licensing procedures and expedite decisions. Delays and uncertainty in the issuance of export

licenses discourage American exporters and handicap them in competition with foreign exporters. This not only hurts our balance of payments, but means lost business for American firms and fewer jobs for American workers. We strongly believe that Agencies concerned with export administration should give full weight to the effects on our foreign trade of export control measures.

And, as I have indicated, Treasury plays an active role in working out and negotiating a variety of U.S. efforts to limit governmental intervention in the international trade, investment and technology transfer areas. We believe strongly that such an approach should govern both international economic relations and the policies of the United States itself.

Table 1

U.S. Trade in Manufactured Goods, Categorized as "Technology-Intensive" and "Non-Technology-Intensive"*

1967-1977

$ Billions

Year	Technology-Intensive			Non-Technology-Intensive			Total		
	Exports	Imports	Balance	Exports	Imports	Balance	Exports	Imports	Balance
1967	8.0	3.1	4.9	12.8	12.7	0.2	20.8	15.8	5.1
1968	9.6	3.9	5.7	14.2	16.7	-2.5	23.8	20.6	3.2
1969	10.7	4.7	6.0	16.1	18.3	-2.2	26.8	23.0	3.8
1970	12.3	5.7	6.6	17.0	20.2	-3.1	29.3	25.9	3.4
1971	13.2	6.6	6.6	17.2	23.8	-6.6	30.4	30.4	0.0
1972	14.1	8.5	5.6	19.6	29.3	-9.7	33.7	37.8	-4.1
1973	19.0	10.6	8.4	25.7	34.4	-8.7	44.7	45.0	-0.3
1974	26.6	12.9	13.7	37.0	42.4	-5.4	63.5	55.2	8.3
1975	28.0	12.3	15.7	43.1	38.8	4.3	71.0	51.1	19.9
1976	31.2	17.0	14.2	46.1	47.8	-1.7	77.2	64.8	12.4
1977	33.4	19.6	13.8	47.1	57.7	-10.6	80.5	77.2	3.3

Note: Negative Balance Figures Indicate that Imports Exceeded Exports

* Source: Regina Vargo updated and expanded figures based on "The Impact of Technological Innovation on International Trade Patters," U.S. Department of Commerce, Bureau of International Economic Policy and Research, Monograph ER-24, December, 1977.

Table 2

Source and Use of R&D Funds in Six Nations in 1975*

Nation	R&D Funds Provided		R&D Performed	
	Amount ($ bil)	%	Amount ($ bil)	%
United States				
Industry	15,787	44.8	24,164	68.6
Government	18,152	51.6	5,397	15.3
Other	1,261	3.6	5,926	16.8
Total	35,200	100.0	35,200	100.0
Japan				
Industry	5,521	63.0	5,634	64.3
Government and other	3,241	37.0	3,128	35.7
Total	8,762	100.0	8,762	100.0
W. Germany				
Industry	4,634	52.3	5,881	66.4
Government and other	4,223	47.7	2,976	33.6
Total	8,857	100.0	8,857	100.0
Canada				
Industry	557	32.7	681	40.0
Government and other	1,145	67.3	1,022	60.0
Total	1,702	100.0	1,702	100.0
United Kingdom				
Industry	1,847	39.2	2,965	63.0
Government and other	2,859	60.8	1,741	37.0
Total	4,706	100.0	4,706	100.0
France				
Industry	2,510	42.0	3,643	60.9
Government and other	3,472	58.0	2,339	39.1
Total	5,982	100.0	5,982	100.0

* latest year for which international figures are available

Source: OECD

Table 3

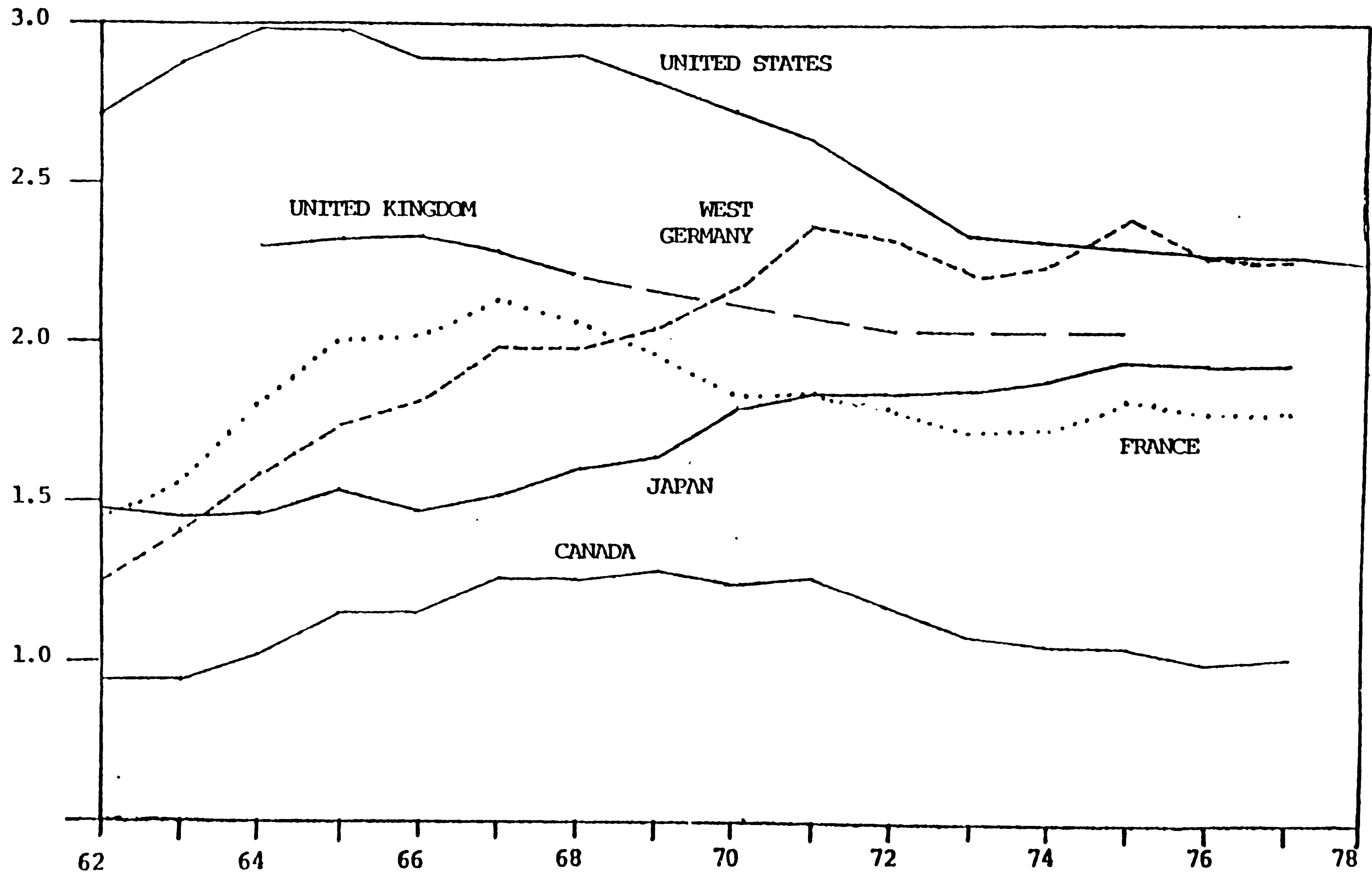
R&D As a Percent of GNP, 1975

	As a percent of GNP		
	Total R&D	Industrial R&D	Industrial R&D Non-Government Funded
United States	2.3	1.6	1.0
Japan	2.0	1.1	1.1
West Germany	2.4	1.4	1.1
Canada	1.1	0.4	0.3
United Kingdom	2.1	1.4	0.8
France	1.8	1.1	0.7

Source: National Science Foundation and OECD

Chart 1

Total R&D Expenditures as a Percent of GNP in Six Nations, 1962-1978*



*Only U.S. available for 1978. Time series data for U.K. R&D are very incomplete. Available information suggests that R&D as a percent of GNP has declined from 2.3 percent in the mid-sixties to 2.0-2.1 percent in the seventies.

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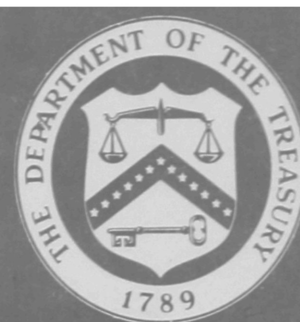

FOR RELEASE AT 4:00 P.M. March 6, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $6,000 million, to be issued March 15, 1979. This offering will result in a pay-down for the Treasury of about $200 million as the maturing bills are outstanding in the amount of $6,200 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,000 million, representing an additional amount of bills dated December 14, 1978, and to mature June 14, 1979 (CUSIP No. 912793 Y9 1), originally issued in the amount of $2,905 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated March 15, 1979, and to mature September 13, 1979 (CUSIP No. 912793 2L 9).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 15, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,577 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, 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, Monday, March 12, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

B-1443

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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders 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 on all accepted tenders 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. 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. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action 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 weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt on March 15, 1979, in cash or other immediately available funds or in Treasury bills maturing March 15, 1979. Cash adjustments will be made for differences between the par value of the 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 these bills 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 these bills (other than life insurance companies) must include in his or her 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 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 AT 4:00 P.M., EST.
March 6, 1979

STATEMENT OF THE HONORABLE RICHARD J. DAVIS
ASSISTANT SECRETARY OF THE TREASURY
(ENFORCEMENT AND OPERATIONS)
AT THE
BOARD OF DIRECTORS MEETING
OF THE WINE INSTITUTE
MONTEREY, CALIFORNIA
MARCH 6, 1979

I appreciate the opportunity to be with you today in Monterey. With all the intense activities that take place in Washington -- meetings, Congressional hearings, the daily mini-crisis and the like -- people in positions like mine sometimes begin to develop the misconception, and there is no doubt that it is a misconception, that the country, or at least all within our particular responsibilities, will grind to a halt if we are not personally there at our desk monitoring all that goes on. As this so-called "self-importance syndrome" develops, a deadly disease if not diagnosed and understood, we lose sight sometimes, I am afraid, of the benefit to all in going out into the country, meeting with people, explaining our goals and ideas and gaining a better appreciation of theirs.

It is with these thoughts in mind that I decided to accept your kind invitation to address this meeting of the

Wine Institute's Board of Directors. It is my hope that in doing so I can provide you with a better idea of our perception of the regulatory issues involving the wine industry, and gain from you increased understanding of your concerns and your views on these matters. Such an exchange is, I believe, particularly important where the wine industry is concerned. I recognize that, having seen a period where your product was totally prohibited, you may view with particular concern even lesser and very different regulatory actions directed at your industry.

The past twelve months have certainly been active ones during which we all have been addressing a wide number of issues and problems. It has seen the Bureau of Alcohol, Tobacco and Firearms (BATF) lose its Director and, just recently, gain a new one; analyses and studies of BATF's responsibilities from a structural point of view, in both the regulatory and the enforcement areas; the final wine labeling rules; consideration of the impact of alcohol consumption on the pregnant woman, and what to do about it; a new proposal for partial ingredient labeling; efforts to review and modernize, if appropriate, BATF rules governing both trade practices and advertising; and a review of the Federal Alcohol Administration Act itself. Interest and activity in many of these areas will continue in the future. It is my hope today to provide you with an overview of how we have dealt with some of these issues, and what our thoughts are about the future.

In an important sense, one of the most significant of recent events is the appointment of a new Director for the Bureau, Bob Dickerson. Mr. Dickerson brings to his new responsibilities long years of experience with the Customs Service, where he served most recently as Deputy Commissioner. The experience he gained there -- as a manager responsible for activities with important commercial aspects -- will stand him in good stead as Director of BATF, particularly as he has the assistance of people of the high caliber of Steve Higgins, the Assistant Director for Regulatory Enforcement, who is with me here today.

Initially, I would like to share with you some of the general ideas that permeate much of what we do.

First, is our belief that there are two core aspects of BATF's responsibilities under the FAA Act -- those that involve assuring that competition within the industry is fair and open and those that assure that consumers of alcoholic beverages receive appropriate, accurate and non-misleading information about the products they are purchasing. Each of these responsibilities has received and will receive full attention by the Bureau.

Second, in determining the appropriate way to implement these responsibilities it is important that we seek to avoid unnecessary burdens on industry. This involves two things: trying to find the least expensive way to accomplish regulatory goals and eliminating those regulatory requirements which no longer serve any useful purpose. The Bureau is, you should know, developing a formal system to help it identify regulations which fall into this latter category; and all its activities will seek to meet the former standard.

Third, regulatory requirements should be as simply and directly stated as possible so that both the regulated and the regulator know what is expected. Related to this is the need to assure that the industry, as well as consumers, in fact know what the rules are, and that significant concepts are not lost in informal rulings and advice. It is largely to work toward these goals -- as well as to assure that the regulations involved are both necessary and responsive to modern business practices -- that BATF has been conducting reviews under the Administrative Procedures Act of the advertising and trade practice regulations.

Fourth, it is our strong view that destructive competition among government agencies is bad. I am sorry to report that in my years as a prosecutor I had occasion to observe the impact of this kind of competition first-hand -- it is not beneficial to anyone; it wastes effort and resources; it causes investigations to be more difficult; and it causes a

loss in necessary public confidence. So, too, with the regulatory world -- destructive competition helps no one, not the regulated, not the consumer, and certainly not the government agencies involved.

If destructive competition is bad, how are we to avoid it? As a general matter, we try to do so by coordinating our efforts with others with whom we share or have similar responsibilities. While uniformity of basic policy is generally desirable, this does not mean that BATF must simply follow the rules of other agencies, such as the FTC or the FDA. In particular situations, differences in the alcoholic beverage industry may justify different results; in others the terms of the FAA Act may not justify requirements totally consistent with that decreed by other agencies under their statutory charters. It is important, however, that we work with these agencies so that the resulting overall system is as consistent and sensible as possible.

We recognize that issues relating to the role of the FDA and FTC in relation to that of BATF in regulating the alcoholic beverage industry are of particular concern to many of you. In the past these issues have at times emerged in the form of competitiveness among these agencies on particular matters, and proposals to assign some of BATF's responsibilities to these other agencies. As you know, last session, legislation was considered by the Congress which would have transferred much of BATF's labeling responsibilities to the FDA.

A source of this competition, and of some of these proposals, is a belief held by some that BATF has not given sufficient priority to its consumer responsibilities and that these responsibilities are inconsistent with some of its tax and other functions. I do not believe that these beliefs are soundly based. Nonetheless, these arguments are raised. And, it is fair to say that if we are to continue to argue that BATF, for example, should not lose its labeling responsibility to FDA, it is important that the Bureau have the ability and the interest to itself exercise those labeling responsibilities in a meaningful way that is fair to both consumer and industry alike. The Bureau, I believe, is trying to do this. This is certainly essential if these arguments for a continued BATF role are to be persuasive within both the Executive Branch and the Congress. And, at the same time BATF in working with other regulatory agencies has, I believe, gone a long way towards building the kind of constructive, non-competitive relationship which can only benefit us all. Credit for this belongs not only to the Bureau but to these other agencies, particularly the FDA.

This leads to two particular issues I would like briefly to raise with you -- ingredient labeling and the problems associated with alcohol consumption during pregnancy. Comments about the recently published proposal for partial ingredient labeling are, of course, governed by the Administrative Procedure Act. I would like, however, to describe something about our approach to this issue.

I recognize that many of those present here have serious concerns about the ingredient labeling issue and question the need for any proposal of this type. It is our view, however, that the notion of ingredient labeling is basically sound, providing consumers with information they desire to have so they can have a basis for selecting among products. A preliminary review of comments at recent hearings conducted by FDA, FTC and the Agriculture Department appear to support this. Before issuing any final rule, however, these materials will be more completely analyzed.

At the same time, however, any regulatory proposal such as this must consider the costs involved for the industry and potentially the public. We have tried to do so. These proposals have been modified from those made earlier and depart in some respects from certain approaches generally followed in ingredient labeling. These include:

-- deletion of the order of predominance requirement;

-- elimination of the sodium level requirement;

-- flexibility as to placement of the list on the bottle;

-- allowance of shotgun labeling for essential components.

In each of these instances, the principal motivating factor behind the change was a desire to reduce costs and adjust the proposals to reflect the realities of your industry.

We also discussed these proposals with the FDA. The result plainly was not a perfect one from their perspective. Nonetheless, they have supported it, believing as we do, that pending the receipt of comments, it reflects a reasonable balance between consumer and industry needs and concerns.

Over the next months we hope to receive comments from you on these proposals. Are there other steps that we can reasonably take that will reduce costs further or are sensible for other reasons? What will these proposals cost? These are some of the questions about which we are seeking information.

We are serious about this proposal. At the same time, let me assure vou that we want vour views and ideas. I cannot promise you that in the end we will agree on everything. I can promise that we will try to seriously deal with your concerns before coming to any final conclusions and that we will do a full regulatory analysis before deciding whether to issue any final rule in this area.

Another labeling issue we have recently been dealing with is the proposal advanced that we should place a label on alcoholic beverage containers warning people as to the risks of consumption for the pregnant woman. Dealing with this issue has been, and remains, difficult. It represents one of the most troublesome issues we have been facing as we struggled to understand better the nature of the medical evidence as well as how to communicate it. We are particularly concerned because we are not here talking about treating

disease, we are talking about the potential to avoid the trauma and tragedy of birth defects. In attempting to determine the appropriate course of action we solicited public comment, retained medical experts as well as one on the value of labeling and other forms of education, and consulted with experts at the FDA, NIAAA and the National Academy of Sciences.

Based on this analysis, we concluded that there was a plain need for public education about this problem to alert people to the risks of serious birth defects for the offspring of the heavy drinker during pregnancy and to the scientific uncertainty and differences -- which our experts reported -- as to the impact of lesser or binge drinking. In this instance we elected not, however, to simply turn to the labeling option.

It seemed to us that we should first try to work with industry, other private groups and other federal agencies to mount a meaningful public education campaign, one involving media efforts, posters and the dissemination of various materials to the public generally as well as to particular groups. We made this choice based on the uncertainties in the medical evidence and a belief that, if it can be done, public education may be preferable to what some may consider to be "just another government warning." We intend to monitor this program as it develops and take polls to measure levels of public awareness about this issue. This will help us decide whether the course we have adopted is sufficient, or whether we must reconsider labeling or other action.

I must confess that some have questioned the wisdom of looking first to voluntary cooperation in this situation. There are those who believe that we should have adopted a labeling proposal now. I do not doubt, however, that this non-regulatory approach can work. First, we have the support of others in the government, and particularly of the FDA. This, I believe, reflects the positive relationship which has developed between the Bureau and FDA.

Most importantly, this program can work because the alcoholic industry, and particularly the Wine Institute, does have a tradition of social responsibility. Given this attitude we are hopeful that together we can demonstrate the ability of government and the private sector to work together without burdensome regulation to perform important and needed public service.

These then are the ways we look at some of the issues about which we share a common interest. I know that sometimes, we in Washington seem distant and non-responsive. While various statutes -- such as the Administrative Procedure Act -- limit the amount of informal exchange we can have on some issues, I hope you will feel that we do desire as constructive a relationship as possible; that we do desire to be sure that decisions are made after full development of the facts; that we do desire that your needs and concerns are fully understood and not ignored; and that we do desire a BATF which carries out its responsibilities in a way that serves both you and the public at large well.

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REMARKS BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY FOR
INTERNATIONAL AFFAIRS
BEFORE THE
SYMPOSIA SOCIETY OF AMERICA
WASHINGTON, D.C.

TOWARD FAIRER INTERNATIONAL TRADE
THE NEW SUBSIDY/COUNTERVAILING DUTY CODE

The problem of defining what is fair and unfair in international trade has been at the root of some of the most difficult, and contentious, issues in international economic relations in recent years:

-- The few accepted international rules we have had to guide us have been poorly implemented.

-- Increasing governmental involvement in economic affairs, in both the industrialized and developing countries (LDCs), has compounded the critical importance of finding new ways to define "fairness" and deal effectively with unfair practices.

-- Subsidy/countervailing duty problems, in particular, have threatened to undermine overall international relations and prevent cooperation in other areas.

B-1445

The United States therefore made the conclusion of a code on the use of government subsidies and countervailing duties its top priority in the Multilateral Trade Negotiations, and a prerequisite to U.S. adherence to any final package of agreements. As a result, the new subsidy/countervailing duty code which has been negotiated in Geneva offers a very important step toward better definitions and improved enforcement against unfair practices in the subsidy area.

Today, I would like to discuss why we consider a subsidy/ CVD code so essential, our objectives in negotiating such a code, and the principal elements of the code which has been negotiated. I will focus on the benefit for the United States which will derive from the code, and why I believe that Congressional approval of the code -- as part of the overall MTN package -- is essential for the United States.

Subsidy Problems

Subsidies have become an increasingly important tool of national economic policy in all nations. They have long been considered critical to development in the LDCs. But the tendency to subsidize has also been accelerated in virtually all industrial nations in recent years as a result of slow economic growth, high unemployment, and strong import competition.

Subsidies are frequently used to help maintain employment, improve industrial efficiency, and stimulate research and development. Unfortunately, they can also become a means of avoiding necessary adjustment to changing global trade patterns.

We can't eliminate subsidies entirely. But we can, and must, seek to set guidelines for the use of subsidies which adversely impact on international trade. The crucial principle is simple: countries cannot be permitted to export their own problems to other countries via export or even "purely domestic" subsidies. Whether such subsidies are explicit aids to exports or directed in the first instance to domestic production, the critical test is whether they cause or threaten injury to foreign producers or seriously prejudice the reasonable expectations of foreign exporters regarding access to domestic markets.

The use of countervailing duties (CVDs) is closely linked to the problem of subsidies. By their nature CVDs are both a tool of economic policy and a political response to the economic programs of other countries. Yet if we cannot agree on which subsidies are "fair" and which are "unfair", we clearly will not agree on when and how much in the way of offsetting countervailing duties are legitimate.

Improved discipline on the use of subsidies and countervailing duties is therefore essential:

- -- to avoid injurious trade distortions;
- -- to "de-fuse" potentially explosive trade problems which threaten overall international relations; and
- -- to assure more rapid procedures for the resolution of subsidy/CVD disputes.

Objectives in the MTN

The Trade Act of 1974, the Congressional mandate for U.S. participation in the Multilateral Trade Negotiations, urged the President to "take all appropriate and feasible steps within his power (including the full exercise of the rights of the United States under international agreements) to harmonize, reduce, or eliminate barriers to (and other distortions of) international trade". The term distortion specifically includes the use of subsidies (Section 102 a and g). The Act also requested the President to update current international agreements making "any revisions necessary to define the forms of subsidy to industries producing products for export and the forms of subsidy to attract foreign investment which are consistent with an open, nondiscriminatory, and fair system of international trade." (Section 121).

We have substantially met these requirements of the Trade Act through the new code. We sought as major components of this code:

-- A reinforcement of the commitment already accepted by most industrial countries not to use export subsidies for industrial products, plus staged expansion of that commitment to LDCs.

-- New international discipline to guard against the disguised protection of domestic markets through internal or production subsidies.

-- Improved discipline over subsidized competition in agricultural products in third markets.

-- Concomitant guidelines on the use of countervailing duties, which would recognize that such duties should be applied only when a subsidy threatens or causes injury to a domestic industry.

-- Prompt recourse to other countermeasures if specific commitments regarding the use of subsidies have not been fulfilled.

-- Effective implementation of rules on both subsidies and countervailing duties, and strengthened provisions on dispute resolution.

-- Acceptance by advanced developing countries of increased obligations on subsidies as their industries become internationally competitive.

The New Code

We have been successful in obtaining new guidelines for the use of subsidies and countervailing duties in virtually

all of these areas. The code spells out specific rights and obligations for all signatories on both subsidies and CVDs along a basic two-track mechanism:

-- The principal right under Track I of the code is the right to countervail any foreign subsidized export which causes injury to a domestic industry. This includes both domestic and export subsidies, on both agricultural and industrial products, from industrial and developing nations alike. Action by the importing nation, after a determination of injury, is simple and direct. It is completely under the control of the importing nation, with no international review required before action can be taken.

The benefits of this provision are multiple:

(1) Domestic subsidies are explicitly recognized as countervailable subsidies under international law, provided injury is shown. In using subsidies to eliminate industrial, economic, and social disadvantages in specific regions, to facilitate the restructuring of certain sectors, to sustain employment and encourage re-training and change in employment, or to encourage research and development programs, nations agree to seek to avoid causing serious prejudice to other nations and to consider possible adverse effects on trade and existing conditions of world trade, production, and supply in the product concerned.

(2) Agriculture obtains the assurance that subsidies of any kind which interfere with our domestic support programs may be countervailable, and that this aspect of injury will be given full consideration.

(3) The introduction of an injury test in U.S. law, which was the major objective of our trading partners during the negotiations. Our trading partners have been especially concerned about the use of countervailing duties by the United States, since for most products (those subject to ordinary duties), we have no injury requirement in our domestic law. We can impose countervailing duties solely on the basis of an existing foreign government bounty or grant. The United States is the only major industrial nation which imposes CVDs without such an injury requirement.

Though it has been strongly resisted by some in the United States who like the automaticity of existing procedures, it has been clear that the fact that the U.S. was not in conformity with the international rules in this area was costing us much more than was justified by the economic protection provided by injury-less CVDs. In strict trade terms, our unwillingness to adopt an injury test simply made others unwilling to adopt meaningful limits on their use of subsidies and other trade-distorting practices. Moreover, as long as our production, employment and trade interests are not adversely affected, we have no reason to object if foreign nations undertake

to subsidize U.S. consumers through their government budget -- why should we countervail and rob our consumers of this benefit?

If U.S. industries are hurt, an injury test will trigger a just response. And, for the first time, we will have the ability to impose provisional measures to protect an industry against subsidized competition even while investigations are still underway.

The new injury test in the code is itself a major improvement over similar standards in domestic and international law. For the first time, industries seeking relief will have a clear idea of the standards to be applied and the specific criteria that will be examined in making determinations. The code spells out in detail the procedures to be followed by domestic authorities, but allows a great deal of flexibility to weigh only the particular factors that are affecting the industry under review. It's not a tougher or easier standard than we have applied in dumping cases -- it's clearer and better.

If the subsidized imports are depressing prices, or preventing sales, profits or full employment in our industry, we will consider the industry "injured." But we will not attribute to the imports other factors that may be causing injury as well, such as changes in consumer taste, obsolete facilities or unsubsidized competition.

-- Under Track II of the code, nations have the <u>right to hit any proscribed export subsidies without a specific injury finding</u>. This both reinforces the discipline of the code itself against such subsidies, and assures effective U.S. reaction whenever the rules are breached.

-- Nations also have <u>the right to retaliate against domestic subsidies which adversely affect their trade through import substitution.</u> This is particularly important because such domestic subsidies can be used to impair GATT tariff bindings for which we have negotiated reciprocal concessions, and can become an alternative to tariff protection to restrict access to domestic markets. Again, injury does not have to be shown where basic GATT commitments have been violated.

-- <u>Counteraction can be in the form of increased import duties (CVDs) on the product concerned, or can involve alternative measures in third market or import substitution cases</u>. This provision greatly strengthens international procedures and specifically sanctions for the first time countermeasures against subsidized competition to the third markets.

If, for example, a nation grants export subsidies on steel or automobiles sold in a third market which adversely affect U.S. sales in that market, the imposition of countervailing duties on U.S. imports may not be relevant. Instead, the United States would be justified in seeking international approval for countermeasures against imports from the offending nation into the United States.

Similarly, if domestic production subsidies are used in a manner which impairs a GATT tariff binding, retaliatory action is warranted on imports of other goods from the offending nation. If, for example, the European Community were to subsidize the production of soybeans (on which we have a zero-duty tariff binding in the EC), we could request international review and authorization for U.S. retaliatory action against a like amount of EC exports to the United States.

In sum, in cases where injury is shown, the importing country can act against imports unilaterally -- no international mandate is needed. Where commitments are violated, countermeasures can be taken without showing injury after sanction by an international body which agrees that the obligation has been violated.

-- The principal obligation under the new code is a commitment not to use export subsidies on industrial or mineral products. Although most industrial nations have accepted a commitment not to use industrial export subsidies in the past, the addition of mineral products is new as is the acceptance of commensurate obligations by signatory developing nations. The Code also deals with the problem of the archaic dual-price criteria in the GATT (Article XVI:4) as a prerequisite for action against export subsidies. We have developed an updated list of export subsidy practices

which are prohibited <u>per</u> <u>se</u>. As a result, in our view there will be no need to demonstrate dual-pricing for any item on the new, updated list.

-- With regard to <u>agricultural export subsidies</u> we have achieved a major step toward resolving the main problems in our important agricultural export markets. The new code would prohibit the use of agricultural export subsidies which (a) displace the exports of others or (b) involve material price undercutting <u>in</u> <u>a</u> <u>particular</u> <u>market</u>. These are tighter criteria than the existing GATT Article 16 provision that agricultural export subsidies should not result in a country gaining "more than an equitable share of <u>world</u> trade".

The current Section 301 complaint by Great Plains Wheat, Inc. against EC export subsidies on wheat to Brazil, Poland, the Peoples Republic of China, and other markets where the United States has strong export interests provides a good example of the way in which this new code provision would operate. Great Plains claims that the EC export subsidies result in both a loss of U.S. traditional exports to particular markets and a reduction in world wheat prices.

Either result could serve as the basis for an international review and determination of whether countermeasures are justified. The code thus provides an important international sanction for action which we might want to take under domestic law, but which would violate present international commitments if we just took action unilaterally.

APPLICATION TO DEVELOPING COUNTRIES

One of the most important recent developments in the world trading system is the growing role and importance of a number of advanced developing countries (ADCs), mainly in Latin America and the Far East. A select group of these countries 1/ have increased their share of world trade dramatically, from 5.1% in 1970 to 8.6% in 1977. One of our major objectives in the MTN has thus been to engage these countries much more effectively in both the functioning and the management of the GATT system, including importantly the subsidy/CVD code.

Developing countries which join the code can fulfill the general obligation to refrain from the use of industrial and mineral export subsidies by assuming obligations regarding the use of these subsidies commensurate with their competitive needs. This provision specifically recognizes that export subsidies are an integral part of many development programs, but that they become less necessary as nations develop. The requirement is designed to encourage the phase-out of export subsidies as nations become more advanced, and hence have less need for such practices. Nations which accept these responsibilities under the code receive an assurance that, as their subsidies are phased out, their exports will not be countervailed unless injury is shown.

1/ Hong Kong, Singapore, Korea, Taiwan, Brazil and Mexico

Brazil, for example, has already announced the phase-out of its major export subsidies over a period of approximately four and a half years within the context of the code. Reductions in its export incentives began in January, and will continue at quarterly intervals. This is a significant contribution to improved discipline in the subsidies area, since Brazil has for some years maintained perhaps the largest subsidy program of any major trading country. It is particularly significant for the United States, since Brazil is our eighth largest trading partner. We regard the Brazilian action as a statesmanlike assumption of the increased responsibilities attaching to its sharply increased role in the world economy, and enormously important in assuring cordial U.S.-Brazilian economic and overall relations in the years ahead.

Brazil's adherence to the code offers real benefits to U.S. industry, which has long been concerned about the very high level of subsidization offered by Brazil to competing industries exporting to our market. Brazilian federal and state export subsidies on such products as textiles, leather products, automobile radios, high carbon ferrochromium and ferromanganese, steel wire rods, steel sheet and plate, non-alloy steel bars and sheets, stainless steel bars, guns, furniture, and resistors, have averaged 25 percent of the value of the product, or more, in recent years. U.S. industries

producing these products should experience more equitable competition from Brazil in these and other industrial products in the years ahead.

Beyond Brazil, we expect other advanced developing nations to undertake similar phase-out commitments, tailored to their own situation, and negotiations are actively underway with a number of them. These phase-out commitments become an obligation under the code. Violation of the obligation permits countermeasures under Track II, following international review and agreement, without a finding of injury.

It should be noted that nations which do not accept the obligations of the code, whether industrial or developing, will not receive its benefits. In particular, the United States does not intend to apply the injury test to subsidized exports from those nations that fail to sign the code and assume appropriate obligations. In the absence of such obligations, we would countervail subsidized imports without an injury determination as in the past. It is extremely important to get as broad participation as possible in the MTN code -- and we believe the benefit of recourse to an injury test in the U.S. is a real incentive for accession to it.

DISPUTE SETTLEMENT

International dispute resolution provisions have been tightened considerably under the code. One of the major

accomplishments of the subsidies code is in fact the development of dispute settlement provisions with sufficient teeth to ensure that the new rules translate into effective international discipline. The Code provides for prompt and expeditious review of international disputes. Cases will be heard and acted upon in a matter of months, not years as with some recent GATT cases. Disputes should normally be resolved within 150 days.

As in all international disputes, bilateral resolution should be first sought through conciliation procedures. If the matter is not resolved within 30 days, however, the Code recognizes the <u>right</u> of any signatory to have a panel of objective experts review the case. Such panels would be charged with reporting to the Committee of Signatories its findings concerning the rights and obligations of the signatories party to the dispute. The Committee (by its nature a more political body than a panel) would then review the findings, issue recommendations, and authorize countermeasures as appropriate.

What particularly distinguishes these procedures from past GATT practice is the elimination of procedural roadblocks which often have hamstrung international actions. No longer will months go by arguing whether it is appropriate to call a panel to review a dispute, and many more months selecting its members. The Chairman of the Committee shall have 30

days to constitute a panel, and once constituted that panel will have to produce its report within 60 days. The Committee in turn will have only 30 days to review the panel findings and make its recommendations. Anyone familiar with the GATT knows that these changes will shift international procedures from a crawl to a sprint.

What does this mean? It means that international rules that rely on multilateral surveillance can work. It means that governments can get results from international bodies in a time frame that is responsive to the needs of their domestic constituents. It means the new discipline on subsidies and CVDs will be enforced.

I know there are some who will argue that no matter how good the new international rules are, they will not be effectively implemented in domestic law. They cite years of frustration with domestic procedures.

Probably the most basic concern in the past was that CVD cases dragged on with no effective remedies available when they were really needed. The Trade Act of 1974 made significant strides in setting deadlines for preliminary and final determinations, and providing judicial review of all such decisions. U.S. procedures now provide unparalleled opportunities for private parties to initiate and participate in proceedings leading to the imposition of CVDs and to obtain judicial review of administrative decisions.

As a result of implementing the MTN Code, we will adopt the first genuine overhaul of our countervailing duty law in 80 years. Consistent with our international commitments we should now have a law that provides, first, for prompt consideration of the twin tests of subsidy and injury; second, for provisional measures within four months of the filing of a petition -- cutting by two-thirds the time now usually taken before the law "bites;" third, an expanded and much more transparent procedure allowing all interested parties to participate and review information collected; fourth, assured periodic review to update the basis on which CVDs are collected; and, fifth, a system under which we can quickly accept undertakings from foreign governments or exporters to end the injurious effects of subsidies to achieve the aims of the law without going through all of its elaborate procedures.

In particular, much tighter deadlines for the conclusion of investigations will be incorporated in U.S. law. Normally, cases will be resolved in less than the one-year period now prescribed in the Trade Act. Conclusion of CVD investigations will be facilitated by the improved notification and consultation procedures in the code. Information on subsidy practices will be more readily available from foreign governments, who will have an incentive to supply all relevant data at the start of

a case lest their exports be subject to provisional measures while the investigation continues. Information will also be available to interested private parties to ensure the transparency of procedures and the accuracy of the data supplied. Standards for claims of confidentiality will be tightened and non-confidential summaries will be required if confidential information is used.

In addition we will expand upon existing procedures to provide detailed and comprehensive determinations of the nature and amount of foreign subsidy practices. Administrative rules will be developed on the calculation of margins of net subsidies, including the use of offsets. Foreign undertakings to offset the adverse effects of subsidies will be primarily limited to agreements among governments so they can be enforced and properly monitored. We believe such undertakings can provide a valuable channel for quick relief for domestic industries, and it is important that the Administration maintain the discretion to enter into such arrangements. Retroactive countermeasures will be available to ensure that such undertakings are not violated. All in all, the new procedures will provide for the open and expeditious resolution of subsidy complaints.

There has also been concern about what practices were considered bounties or grants under our CVD law. The new

code clarifies this matter and plainly recognizes that all subsidies, both export and domestic, are liable to CVD action, depending on the effects of the subsidized goods on international trade.

Finally, a word about the past waiver of CVDs. The Congress included authority in the Trade Act to waive CVDs under three strict conditions to facilitate negotiation of the MTN subsidies code while still guarding the interests of affected domestic industries.

We believe that the waiver has served its purpose:

-- In almost every case, we have gotten substantial reductions in the amount of the subsidy.

-- The waiver has allowed the MTN negotiations to continue on agriculture, enabling us to gain new and important concessions for U.S. agricultural exports.

-- The waiver has provided a bridge to facilitate acceptance by several developing countries of increased responsibilities in the world trading system. For example, the Brazilian commitment to phase out its major export subsidies completely was clearly promoted by our unwillingness to waive on several specific products early in this Administration and our willingness to do so, under proper conditions, in the textile case last November. Uruguay, in return for a waiver on particular products, likewise agreed to phase out all of its export subsidies over a four-year period.

We don't foresee the need for waiver authority once the MTN Code is implemented in U.S. law. The injury test should set the standard for the imposition of CVDs. We strongly believe, however, that the old authority should be extended in order to avoid disruptions during the transitional period until the MTN code is approved. We are gratified that the House has acted so expeditiously to do so, and we hope that the Senate will do so shortly.

CONTINUING PROBLEMS

The new subsidy/countervailing duties code will not solve all of the international problems regarding the use of subsidies. Export credits and investment incentives are two major areas which the new code does not address firmly. The United States is seriously concerned about the potential for friction in both of these areas in the future, if positive steps toward improved cooperation are not achieved soon. These issues are being dealt with in other fora.

We had hoped that the International Arrangement on Official Export Credits, which was concluded by 22 countries plus the European Community in early 1978, would form the basis for cooperation among the major trading nations to curb excessive competition in the use of official export credits. It is a significant agreement, but further action is necessary to restrain aggressive government financing practices and reduce the element of subsidy in official export credit financing.

At the direction of both the President and the Congress, we negotiated throughout the latter part of last year in an effort to expand the scope and tighten the terms of the Arrangement. We have seen no real progress to date, however, and now find the only realistic alternative is to meet foreign official export credit financing through aggressive action by our own Export-Import Bank. While we hope there will be improved international cooperation in this crucial area, we cannot and will not permit unfair financing of exports by foreign official export credit agencies to deprive U.S. exporters of sales.

Problems in the investment area are becoming more serious as well. There is no system of international rules for investment similar to those for trade in the GATT, as now enhanced by the subsidy/CVD code. We have been addressing investment problems in a number of international fora and will continue to pursue the resolution of especially difficult problems both multilaterally and bilaterally.

We have had particular problems with government intervention in the investment process. This takes many forms, but it usually combines two basic features: incentives to attract the investment in the first place and performance requirements, including offset requirements, to assure that the U.S. firm contributes to the priority economic and social goals of the host government. These performance

requirements typically focus upon local job creation, minimum local value-added, and technology transfer.

In recent years, offset requirements have been most common in the area of defense procurement but they are quickly spreading to the non-defense area as well. Foreign governments frequently require that, for a U.S. firm to do business with the government, it must agree to transfer technology to the nation by means of licensing or co-production agreements. Although inconsistent with the spirit of the GATT and the concept of an open multilateral trade and payments system, these requirements are rapidly becoming a pervasive feature of the world economy.

A major objective of U.S. policy must be to achieve multilateral discipline on such incentives and other interventions, both to maintain an open investment environment and to avoid our being forced into the adoption of emulative countermeasures. With offshore output by multinational firms now approaching a value of $1 trillion, it is anomalous that no such disciplines now apply to the international investment process.

CONCLUSION

The subsidy/CVD code has therefore not solved all the problems of defining and assuring "fair international trade." But it marks a major step in the direction of doing so, and offers the United States a number of new specific benefits:

(1) We have a much stronger prohibition of industrial export subsidies, complemented by an updated list of prohibited export subsidy practices. This new list includes such practices as export inflation insurance, exchange risk guarantees, and duty drawbacks in addition to items carried over from the previous GATT list.

(2) Explicit recognition that countries must accept responsibility for the trade effects of their domestic subsidy programs, and express commitments that they will avoid granting such subsidies that adversely affect the trade interests of other countries.

(3) Domestic subsidies which impair GATT tariff bindings through import substitution are subject to countermeasures as a violation of GATT commitments. Such subsidies may include, but are not limited to, regional development grants, research and development grants, government provision of infrastructure services, and government financing of commercial enterprises, including provision of loans and guarantees on non-commercial terms.

(4) Export subsidies on industrial products to third markets are subject to countermeasures, as are export subsidies on agricultural products which displace the exports of others or involve material price undercutting in a particular market.

(5) The code permits for the first time the use of provisional measures before the application of countervailing duties. Provisional measures may be applied after a preliminary subsidy determination, for a period of up to four months.

(6) Developing countries for the first time are agreeing to phase out the use of export subsidies as part of their obligations, commensurate with their competitive needs, under the new code. This is especially important to a number of U.S. industries which face import competition from highly subsidized exports from Brazil, and from other developing nations which we expect to join the code.

(7) We have an improved framework for conducting domestic countervailing duty investigations. U.S. industries will have a clearer idea of what is required to prove injury, more certainty in proceedings, and consistency in application of the injury test.

(8) New procedures should shorten somewhat the time required for investigation and application of final countervailing duties.

(9) Finally, tight deadlines (a maximum of 150 days) on the dispute resolution process assure prompt international review of subsidies which violate code or other GATT commitments.

These are substantial benefits for the United States. Our agreement in return, to adopt an injury test in our

domestic law, is a fair deal and makes sense for U.S. producers and consumers alike. We are convinced that the code provides a much more effective basis for the resolution of international subsidy problems then has existed in the past, or could possibly exist in the future without the code. It is an essential component of the package of agreements we have achieved as part of the Multilateral Trade Negotiations to deal with the major trade problems of the 1980s.

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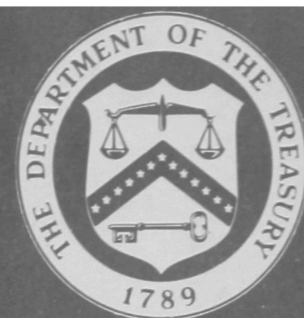
WASHINGTON, D.C. 20220 TELEPHONE 566-2041



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STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE FINANCIAL ANALYSTS FEDERATION
NEW YORK CITY, NEW YORK

The Outlook for the U.S. Balance of Payments

The U.S. balance of payments position has undergone substantial changes in recent years. It moved from what was then regarded as a sizable deficit in 1971-72 to a huge surplus in 1975 and then into even larger deficits in 1977-78. These movements have to an important extent reflected the rapid changes which have been occurring in the global economy in recent years, and point to the need for both the United States and the world economy as a whole to adjust more effectively to these changes.

Some of the developments which have had a strong impact on U.S. and world payments positions have been short-term in nature, such as the short supply of world grain supplies in 1973-74. Others have been of a more fundamental structural nature and will be with us for some time to come. These

changes -- generally slower world growth rates, reduced rates of productivity growth, higher inflation rates, higher oil prices, increased competition in manufactured goods from the advanced developing nations -- will require longer term adjustment strategies in both the United States and other nations in order to assure continued stability for the international monetary system and world economy as we move into the 1980s.

After reviewing briefly the short-term outlook for the U.S. balance of payments and the firm measures which the Administration undertook last fall to return order to the foreign exchange markets, I will focus the bulk of my comments today on the longer-term structural issues that face the world economy and suggest some of the problems we need to begin acting on now to adjust to them.

The Outlook for 1979

As you know, the U.S. current account position moved from a $18 1/2 billion surplus in 1975 to an estimated $16 1/2 billion deficit in 1978, due in large part to the sharp deterioration of our trade balance from a $9 billion surplus to a $34 billion deficit during this period. Much of this change has reflected:

1. the dramatic increase in world oil prices, and our increase in demand for imported oil;

2. differential growth rates among the major economies (with the U.S. growing more rapidly than its principal trading partners in sharp contrast to the experience of the earlier postwar period); and
3. changes in price competitiveness during 1975-76 as a result of higher U.S. inflation and appreciation of the dollar.

Since early last year, we have been seeing a sizable and steady reversal of the deterioration in the U.S. external position as growth differentials narrowed and U.S. exports became more competitive due to the real exchange rate changes of 1977/78. The disruption in Iranian oil production will of course have an impact on U.S. and global developments, to an extent which is still difficult to determine. But the short-term outlook for both the United States and the world is basically encouraging. We are clearly moving in the right direction.

Already in 1978, the U.S. current account deficit declined sharply from an annual rate of over $30 billion in the first quarter to a rate of $11-1/2 billion in the second half of the year. In 1979, the current account should continue to strengthen. We continue to expect a current account deficit for the year at roughly one-half the 1978 level -- something like $8-9 billion. This reflects:

-- A $25-26 billion gain in non-agricultural exports, (excluding gold), compared with a probable increase of about $16 billion in non-petroleum imports, and thus an improvement of $9-10 billion in those parts of our trade position which most accurately indicate the competitive position of the United States in the world economy;

-- An additional $3-4 billion of gold auction effects;

-- Further improvement of $2-3 billion in our sizable surplus on services transactions, which totaled an estimated $22-1/2 billion last year;

-- A rise in agricultural exports of about $1 billion (as compared to a $6 billion increase in our agricultural exports in 1978); and

-- An offsetting increase of at least $8 billion in our oil import bill, based on continued growth in oil consumption and the December oil price increases.*

*(The 5 percent reduction in consumption called for by our recent agreement in the International Energy Agency is equal to a 10 percent reduction in U.S. imports, and potential import savings of $5 billion.)

The U.S. balance on non-agricultural exports and non-oil imports should show steady gains throughout 1979. We expect a positive gain by the fourth quarter of $8-1/2 billion (annual rate) as compared to the fourth quarter of 1978, after a gain of $8 billion from the fourth quarter of 1977 to the fourth quarter of last year. There has thus been substantial progress in those parts of our trade which perhaps best reflect underlying U.S. competitiveness in the world economy.

In volume terms, we expect non-agricultural exports (excluding gold) to grow about 11 percent this year over last, in contrast to an increase of less than 1 percent in non-petroleum import volume. Average unit values on both sides are projected to increase about 11-12 percent. Our invisibles estimates include a rounded $1 billion allowance for possible first-year effects of Iran's recent cancellation of military sales orders. Also, our non-agricultural export projection includes a rounded $1 billion allowance for reduced non-military sales to Iran.

Our estimate of a $50 billion oil import bill this year, made after OPEC announced its pricing schedule for 1979 in mid-December, would not necessarily be increased if further increases in OPEC oil prices were offset by volume effects of the Iranian shortfall and by U.S. conservation efforts. Increased U.S. sales to OPEC countries financed by

their own higher earnings could also help offset any higher oil bill. Nevertheless, it is of course possible that the oil bill might rise by a few billion dollars and we are watching this situation on a daily basis.

Short Term Policy Response

The strong U.S. recovery in employment and production since the recession of 1974-75, through which twelve million new jobs have been created, has not been matched by equivalent success in maintaining the value of our currency at home and abroad. Much of the sharp deterioration of the dollar last fall was due to a lack of confidence in our ability to bring inflation under control. The acceleration in domestic inflation served to weaken the dollar on the foreign exchange markets, and this in turn raised the domestic price level even further -- as the cost of imported goods rose and provided an umbrella for domestic price increases. Hence the Administration and Federal Reserve have adopted a comprehensive program to support the dollar and to impose greater monetary restraint domestically:

-- We submitted a tight fiscal 1980 budget, with an anticipated deficit of under $30 billion -- barely more than 1 percent of GNP, as compared with deficits currently averaging about 4-1/2 percent of GNP in the other major industrial countries.

-- Tight monetary policy is complementing fiscal restraint, as evidenced by a further pronounced rise in interest rates and a sharp slowdown in the growth of the principal monetary aggregates.

-- These measures of demand restraint are being supplemented importantly by wage and price standards, which are gaining a broad measure of support and compliance on the part of the American people.

-- We have adopted a program of gold sales to the private market as a means of helping to reduce the trade deficit and in response to the adverse psychological atmosphere in the foreign exchange market which has undermined international monetary stability.

Once these actions addressing the fundamentals were decided or in place, it became feasible to announce on November 1 a program of coordinated intervention in support of the dollar together with Germany, Japan, and Switzerland. The U.S. has mobilized most of the $30 billion in foreign exchange resources being used to finance our share of this effort -- partly through use of U.S. reserves and partly by borrowing, including the issuance of foreign curency denominated securities.

The United States is fully committed to achieving the fundamental economic conditions required for a strong

and stable dollar. The situation in the foreign exchange market has clearly improved since our November actions. The severe and persistent disorders of October have been overcome. The dollar has appreciated substantially from its lows, although there have been up and down movements in rates from day to day.

The oil price increases and uncertainties about the oil supplies are the principal cause of current uncertainties but the foreign exchange market has been taking these uncertainties in stride. I believe that the market now realizes that the United States is determined to prevent a re-emergence of disorderly conditions which led to the November measures. We will not hesitate to use the substantial resources at our disposal for this purpose. I believe we will see increased stability as our determination to persevere becomes more evident, as indeed we have now for almost three months, and as the outcome for 1979 becomes still clearer in the minds of market participants.

Longer Term Issues

For the medium and longer term, however, a number of more far-reaching problems face the global economy. Many countries, including the United States, are in need of substantial structural change. We need to take advantage of the current breathing space to begin addressing these problems decisively.

In the case of the United States, three problems are particularly important: high energy imports, our need to expand U.S. exports, and low productivity growth. I would like to turn to a discussion of these problems and what the United States is doing about them currently -- and what both the government and private industry must do in the future to implement needed structural changes.

Energy

First, we must drastically cut our use of energy. The Iranian situation is again bringing home to American consumers the urgent need for action in this area. It is clear that the sharp rise in U.S. energy consumption, combined with declines in our domestic production, provided a major portion of the economic underpinning for the massive price increases levied by OPEC in 1971-1974. It is equally clear that the drastic rise in U.S. payments for oil imports -- from less than $5 billion in 1972 to $45 billion in 1977 and $50 billion or more in 1979 -- is the largest single cause of our current account deficit, which in turn has been a source of instability in international financial markets.

The implementation of the first part of the Administration's energy program, after substantial delay in securing Congressional passage, has already promised to help reduce 1979 energy imports from levels they would otherwise have attained. The expected savings is in the area of 500,000

barrels a day or $2 billion in the U.S. import bill.

A number of additional energy measures are either in effect or under review in efforts to further reduce U.S. energy consumption:

(1) The mileage of the U.S. new car fleet has already improved by 5 miles per gallon since 1974, and further improvement of 2 miles per gallon during the next two years is expected.

(2) We are planning to boost the capacity of the Alaskan pipeline by 200,000 barrels a day in 1980.

(3) We are considering appropriate means to raise the domestic price of oil to world levels as we agreed at the recent Bonn Summit.

(4) By 1985 we intend to increase our coal production by two thirds.

(5) For the longer term we are looking into expansion of nuclear and solar use.

(6) In the past, each 1 percent growth in U.S. GNP has generated an equivalent 1 percent growth in U.S. demand for energy. We have already made some progress in reducing this rate of energy growth and hope to achieve a 0.8 percent increase in domestic energy demand for each 1 percent growth in GNP.

Joint international efforts to help restrain energy consumption are also an important complement to further action at home. The International Energy Agency governing

board in fact agreed on March 2 to a 5 percent reduction in oil consumption in all member countries in light of current supply disruptions. This is a good start, though much more of course remains to be done to meet our overall need for energy conservation.

Export Expansion

Second, the United States must become much more export-oriented. In times past, exports did not seem to matter much -- either to the individual firm, or to the country as a whole. As a result, neither our private sector nor the U.S. Government tried very hard to expand U.S. exports. Now exports have become critical to both:

-- Until a few years ago, the United States accounted for over 50 percent of the world economy; now, the market in the rest of the world is bigger than the U.S. market for virtually every industry.

-- The share of exports in our Gross National Product has already doubled since the early 1960s, and exports now contribute more to the GNP than does private capital investment.

-- One of every eight jobs in our manufacturing sector produces for export, as does one of every three acres of U.S. farm land. Our future prosperity at home is closely tied to our success in boosting sales abroad.

-- A healthy and expanding export sector is essential for the long-run stability of our external accounts and thus of the dollar. Indeed, increased U.S. exports are by far the most constructive response to our trade balance and dollar problems.

Although we earn a lot from foreign investments, we won't have enough to pay for the imports we need and want unless we can achieve substantial export growth -- one which more nearly parallels the percentage growth in U.S. imports. This particular structural change -- the need to increase the share of production going to exports and import competition -- requires policy measures on a number of fronts:

-- We must keep inflation under control. This is obviously important to every American consumer but also to avoid losses in U.S. price competitiveness for products sold abroad and for those which compete with imports.

-- We must maintain international monetary arrangements which avoid jeopardizing the competitive position of any individual country, as occurred for the United States in the final years of the Bretton Woods system of fixed parities.

-- We must avoid protectionist trade policies, at home and abroad, which would shrink our overseas markets just when we need their maximum expansion and indeed, as

in the Multilateral Trade Negotiations now coming to a conclusion in Geneva, further reduce trade barriers abroad to improve the competitive opportunities for U.S. firms.

-- We must provide full U.S. Government support for the export efforts of American firms, as through the Export-Import Bank in the area of export finance, whenever necessary to support their full competitiveness in world markets.

-- Most importantly, we need to foster a greater export consciousness on the part of American business.

In September 1978 President Carter announced a number of new measures designed to stimulate increased U.S. exports as part of a new national export policy. The President has expressed his commitment to this effort as a matter of high national priority. The program will significantly increase U.S. Government support for U.S. exporters through direct stimulus to exports and action to reduce both psychological and real barriers to U.S. exports. The new measures include:

-- A proposed $500 million increase in the Eximbank's direct loan authority for FY 1980 to help improve the Bank's competitiveness and flexibility in terms of interest rates, length of loans, and percentage of transaction financed.

-- Loan guarantees of up to $100 million by the Small Business Administration to help small exporters.

-- An additional $20 million for Commerce and State export development programs.

-- Careful review by Executive departments and independent regulatory agencies of the posssible adverse effects on our trade balance of major administrative and regulatory actions, including the use of export controls for foreign policy purposes.

As the President noted in his export policy message, "We can and will continue to administer the laws and policies affecting the international business community firmly and fairly, but we can also discharge that responsibility with a greater sensitivity to the importance of exports than has been the case in the past." Since September the Federal Government has made decisions in a number of cases which reflect this commitment to increase U.S. exports and to carefully weigh the impact on U.S. trade of potential controls on exports for foreign policy reasons.

We have, for example, authorized the export of $280 million of flat-bed trucks and commercial aircraft to Libya since September, and over $200 million in technical data and equipment for exploration and production of petroleum and natural gas in the Soviet Union since the imposition of

special controls in August 1978. The Export-Import Bank has also issued a letter of interest in financing $270 million worth of hydroturbines to Argentina. Each of these cases involved both foreign policy and economic considerations of some importance, and might not have resulted in U.S. export sales under previous Administration guidelines.

Productivity Growth

U.S. output per manhour in the manufacturing industries increased only about 25 percent between 1970 and 1976, while Japanese productivity grew by more than 50 percent, and German, French and Italian productivity grew by more than 35 percent. Last year, American manufacturing productivity grew by only 0.8 percent.

Many factors determine the rate of growth of labor productivity. One of the most important of these is the rate at which we expand our capital base. The stock of productive capital per worker increased every year in the post-war period up to 1974. Since then, the process of capital accumulation has come to a complete halt.

There are many reasons for this: declining real profit margins, uncertainties about energy costs and availabilities, excessive regulation. We have taken steps to remove these roadblocks.

A successful anti-inflation program will help restore after-tax real profits. A stronger dollar will enhance the environment for portfolio investment. The tax legislation

of 1978 will assist investment through a cut in the corporate rate, a reduction in capital gains taxation, and an improved investment tax credit -- resulting in a net reduction of $7 billion in taxes on income derived from capital investment. The energy legislation enacted by the last Congress will eliminate some of the uncertainties about supplies of energy, particularly natural gas.

Finally, investment should benefit from our efforts to get control of the unnecessary preempting of resources by regulatory authorities. The Carter Administration is the first Administration ever to institute an internal program for a cost-benefit assessment of individual regulations. The costs are staggering. We intend to pare them down.

<u>Responsibilities of Others</u>

We need to do more, both within the government and in cooperation with private industry in order to improve our payments position over the longer term. But the United States, clearly, has begun to move on all three fronts where major structural adjustment is needed: energy, export promotion, productivity growth.

Other nations must also do their part. Japan is perhaps the best example of a nation which also needs to make major structural adjustments from the surplus side of the external accounts. The need holds true for many other nations as well, but let's look at the Japanese case to illustrate the point.

First, Japan can no longer rely on export-led growth. Such a strategy was viable when Japan was a small factor in the world economy, and may have been necessary when balance of payments constraints represented the major limitation on Japanese economic expansion.

Now, however, Japan is simply too big to rely so heavily on the world market--particularly in light of the slower growth of the world economy as a whole, and the global payments imbalances triggered by the rise in energy prices. World trade is also growing more slowly, and excessive emphasis on export-led growth promises future friction in trade (and potential monetary instability as well). We can no longer all expect to pull ourselves up by someone else's bootstraps.

Japan's domestic needs are huge, and are widely recognized in Japan. The balance of payments and the level of reserves are no longer a constraint on Japanese economic activity. It thus appears feasible for Japan to begin this particular structural change.

Second, Japan needs to integrate imports -- particularly of manufactured goods -- more fully into its economic life. The share of manufactures in Japanese imports today is much lower than in any other industrialized country.

This phenomenon too derives from conditions which may have been justified, and even necessary, in the past. As with export-led growth, however, Japan has simply become too big to maintain an import composition so significantly different

from the other major countries. Fortunately, as also with export-led growth, Japan can well afford to adjust its policies and performance in this area. As the United States must adopt and maintain an effective program of export promotion, Japan must adopt and implement an effective program of import promotion.

Conclusion

It is obviously too soon to know the response of either, or both, of our countries to the enormously complicated process by which structural change of a politically sensitive nature can be brought about. It may turn out that Americans will always consume more energy per capita than citizens of other countries, and that Japanese will always be a bit more effective competitors in international trade. But both have made a meaningful start toward the essential international norm. Other nations must do so as well.

We do know that the costs of failure to proceed down these paths would be very high. All countries would suffer grievously from the impact of inevitable global instabilities if we cannot find ways to move, steadily and decisively, toward a new equilibrium.

To date, however, we have only a start. The needed changes may take years to complete. It is thus imperative to move as fast as we can. The rewards of success will be great, and the penalties of failure extremely high.

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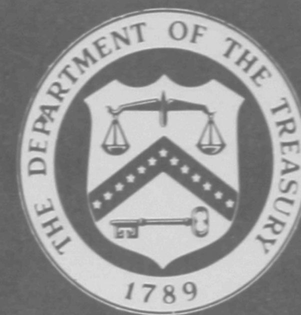

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STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
TASK FORCE ON NATIONAL SECURITY AND INTERNATIONAL AFFAIRS
COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

Mr. Chairman. I am very happy to testify before this Committee on the budgetary effects of our FY 1980 appropriations request for the multilateral development banks.

Our participation in these banks is a particularly cost-effective means of extending U.S. assistance to poor countries and poor people around the world. This is because they enable us to share the burden of providing foreign economic assistance with other countries, and because the banks leverage their limited paid-in capital subscriptions by borrowings in private capital markets based on our callable capital subscriptions and those of other countries.

Other countries now contribute $3 to the banks for each dollar which we ourselves make available. Twenty years ago,

at the time that the Inter-American Development Bank and the World Bank's International Development Association were being formed, the United States contributed three-quarters of all economic assistance, 35 percent of all contributions to the MDBs and 50 percent of their concessional funds. We have reduced the U.S. share in virtually every negotiation for replenishing the MDBs, and we will continue to do so.

In addition, the capital structure of the banks permits them to leverage their relatively small amounts of paid-in capital by borrowing in private capital markets. Indeed, nine dollars are raised in the private capital markets for each dollar which is paid into the banks with public funds. In the case of the World Bank, cumulative U.S. paid-in subscriptions of $884 million since the Bank's establishment in 1946 have supported gross lending of more than $45 billion -- giving us leverage of more than 50:1 from our budgetary contributions.

It is thus clear that the multilateral development banks operate in a manner which is highly advantageous to the United States from a financial point of view. All these financial and economic benefits would help justify the program, however, only if the banks succeed in their fundamental purpose -- stimulating economic growth in poorer countries and helping poor people throughout the world.

With respect to reaching the poor, all of the banks are showing considerable progress. The World Bank has established ambitious goals and achieved significant successes in reaching the rural poor -- increasing productivity and raising incomes through the use of improved seeds and fertilizers, and the application of modern agricultural methods. They have also set ambitious goals for themselves in reaching the urban poor -- providing sites and services for low income housing, promoting employment through labor-intensive practices in a number of industries and looking for innovative ways to encourage establishment of artisan and cottage industries.

In the Inter-American Development Bank, agreement was reached last December that half of all lending for the next four years will benefit low income groups. In addition, the Bank's concessional resources are to be targeted on the poorest countries in the hemisphere and at low income groups. In the Asian Development Bank, new agricultural sector priorities include expansion of rural employment opportunities, extension of programs to benefit rural women, and improvement in rural infrastructure such as feeder roads facilitating farmers' access to inputs and enabling them to get their production to market.

The multilateral development banks, of course, are extremely effective in a wide range of operations. Over the years, they

have developed important skills in project design, sector and country programming, macro-economic policy leverage and infrastructure support. We want the banks to continue these programs, along with their new emphasis on reaching the poor directly, in ways which will promote both productivity and equity, throughout the developing world -- a large number of countries of great and growing economic, political, security and humanitarian interest to the United States.

This year the President has requested overall budgetary authority of $3.6 billion for the banks. The request consists of two parts: the first is $1,842 million for paid-in capital subscriptions and for contributions to the concessional windows of the banks, amounts which will eventually result in budget expenditures. In addition, there is $1,782 million for callable capital subscriptions to the banks which serve as backing for their borrowings in the private capital markets and which are virtually certain never to result in actual budget expenditures.

In terms of budgetary authority, this year's request for the banks is slightly more than last year's request of $3.5 billion and substantially more than the actual appropriation of $2.5 billion for FY 1979. However, leaving aside the amounts for callable capital, which will not produce budget outlays, the request will result in expenditures of $286 million or 13 percent less than the expenditures

called for in last year's request. Compared to the expenditures from last year's actual appropriation, expenditures resulting from this year's request will be up by $211 million or approximately 13 percent.

The actual outlays during FY 1980 that will result from this year's request are limited to approximately $150 million. Although we must make our subscriptions on schedule in order to bring the burden-sharing agreements into effect and enable the banks to enter into loan commitments, U.S. funds are paid to the banks from the Treasury only as they are needed to meet disbursement requirements under actual loans or on the basis of an agreed drawdown schedule. This process is spread over a period of many years with relatively small pay-outs taking place in the first one or two years following approval of individual loans.

My final point concerns the financial and economic benefits that flow to the United States as a result of our participation in the banks. These benefits derive from project related procurement of goods and services financed through bank loans, bank administrative expenses in the United States, net interest paid to U.S. holders of bank bonds, and LDC growth due to bank financed development projects which has helped stimulate the fastest growing market for U.S. exports.

Our studies show that U.S. real GNP increased between $1.2 billion and $1.8 billion annually over the 1972-1977

period as a direct result of U.S. exports of goods and services to markets created by MDB financed projects. This means that every dollar we paid into the MDBs generated between $2.40 and $3.40 in real economic growth annually over the most recent period for which data are available. This growth in turn led to the creation of between 53,000 and 103,000 American jobs in each of those years. The impact on U.S. GNP and job creation is still greater when one takes account of the indirect effects of the banks in promoting faster growth in the recipient countries and the banks' administrative expenditures, including direct employment of Americans, in the U.S. economy.

From the overall balance of payments perspective, direct accumulated receipts by all segments of the U.S. economy as a result of our participation in the MDBs have exceeded outflows by $2.4 billion over the life of banks up to the middle of 1978. The indirect effects of faster LDC growth would add further to this total as well. This net figure of $2.4 billion encompasses U.S. merchandise and services exports due to LDC procurement through MDB loans, administrative expenses of the MDBs in the United States, U.S. contributions and subscriptions to the MDBs and net MDB portfolio capital flows into the U.S. capital market.

The multilateral development banks are thus not giveaway programs. From any angle we wish to examine their impact --

on the budget, the balance of payments, the overall economy -- the results are strongly positive. The banks produce these financial and economic benefits while helping us achieve important foreign policy objectives of economic growth, stability, security and avoidance of conflict in the developing regions of the world. We hope the Committee will include the full request in its FY 80 budget proposals.

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

FOR RELEASE ON DELIVERY
March 8, 1979
10:00 A.M.

STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY (DOMESTIC FINANCE)
BEFORE THE H.U.D.-INDEPENDENT AGENCIES SUBCOMMITTEE
OF THE SENATE COMMITTEE ON APPROPRIATIONS

Mr. Chairman and Members of this Distinguished Subcommittee:

I am pleased to present the Administration's initial budget request for the National Consumer Cooperative Bank.

The National Consumer Cooperative Bank Act was signed into law by the President on August 20, 1978. The Act establishes a bank to make sound loans at market rates of interest to cooperatives in a variety of fields. It also creates an Office of Self-Help Development and Technical Assistance within the Bank to extend capital advances and to make management and technical assistance available to cooperatives with special needs.

Last September the Administration established an Inter-agency Task Force, which I chair, to expedite implementation of the Act. The Task Force held 19 public meetings on the

B-1448

Bank in Washington and around the nation. At these meetings, people who are members of cooperatives or who are interested in forming cooperatives voiced deep interest in the Bank.

The Bank

The Bank is modeled on the highly successful Banks for Cooperatives, which make credit available to agricultural cooperatives. It was established to satisfy the unmet credit needs of other cooperatives, particularly consumer cooperatives. The Bank represents an effort by Congress and the Administration to achieve increased growth and stability for cooperatives in order to secure lower consumer prices, enhanced power for consumers in the market place, and a fair share in the benefits of cooperatives for low income people. The request that I present today will allow the Bank to begin moving toward these goals.

Like the Banks for Cooperatives, the Bank will initially be financed with a government investment that will be redeemed over time. And like them, it is intended to operate on a sound and self-sustaining financial basis.

The Bank's Self-Help Development Office will be separate from its lending operation. It's Self-Help Development Fund will make capital advances, or soft loans, to cooperatives which cannot secure adequate financing from hard loan sources. These capital advances will help satisfy cooperatives' need

for equity and junior debt. The advances will increase cooperatives' financial soundness and will help them qualify for conventional loans from the Bank and other sources. This is particularly important for new cooperatives and for cooperatives serving low income people. The Office's technical assistance program will offer management and technical assistance to cooperatives, including low-income credit unions that are not eligible to become borrowers.

Budget Summary

Our budget request can be summarized as follows. For FY 1979, we seek a $40 million appropriation for capitalizing the Bank (purchasing its Class A stock); $10 million for capitalizing the Self-Help Development Fund; and $2 million each for the Bank's administrative expenses and of the Self-Help Office, which include the expenses of its technical assistance program. For FY 1980, we seek an additional $60 million for Class A stock, $20 million for the Self-Help Fund, $2.459 million for the Bank's expenses, and $6.441 million for the expenses of the Self-Help Office.

Capitalizing the Bank

The moderate capital investment that we have requested is necessary to establish the Bank as a sound, independent entity capable of generating sufficient earnings from its nation-wide business to repay the government's investment

over a reasonable length of time. Our FY 1979 request for funds for purchasing Class A stock is significantly below the $100 million authorized by Congress for that year. However, our fiscal year 1979 and 1980 requests together should satisfy the Bank's capital needs in those years and firmly establish it as a self-sufficient, independent entity.

The Bank's Class A stock is preferred stock yielding cumulative dividends. The dividend rate will be determined by the Secretary of the Treasury, who will take into consideration the market rate for Treasury securities of comparable maturity. Until October 1, 1990, however, dividends are limited to 25% of the Bank's net income.

The government's investment will be repaid out of the Bank's retained earnings and the proceeds of required purchases of stock by cooperative borrowers. As I noted before, the model for this procedure is the highly successful Banks for Cooperatives in the Farm Credit System. The statute requires that the Bank retire the Class A stock as soon as possible consistent with the Act's purposes. It also requires that the proceeds of all sales of Class B and C stock after October 1, 1990 be used for this purpose.

Until all the Class A stock is redeemed, the President of the United States will appoint at least six members of the Bank's thirteen member board of directors. Thereafter,

he will appoint only one. I expect that after its initial organizational phase, the Bank will place a high priority on retiring the Class A stock. In this way the Bank will be independent and wholly controlled by cooperatives as soon as possible.

Lending Policies

The Bank's objective is to make sound loans at market rates of interest. The statute requires that every loan be fully repayable in accordance with its terms and conditions. It also requires that as long as the Bank is making loans from government capital, it must charge interest rates that are at least equal to rates prevailing in the local area for loans from other sources for similar purposes and maturities. The loan program will thus be a hard loan program.

By the end of FY 1980, the Bank should have nearly $100 million in loans outstanding if the requested appropriations are granted. This would constitute a significant step toward meeting the needs of cooperatives for conventional credit. Among the types of cooperatives assisted would be food coops, housing coops, low-income agricultural coops, energy coops, health care coops and handicraft coops. By statutory mandate, the Bank must use its best efforts to see that 35% of the total goes to cooperatives serving low-income people. Low-income people will thus share substantially

in the benefits from increased growth in cooperatives. In order to assure that existing small businesses are not unfairly harmed, the Bank will assess the impact of its loans on small business.

The Bank is authorized to leverage its resources by borrowing in the credit markets. However, we assume that the Bank will do no borrowing in fiscal years 1979 or 1980. We also assume that the Bank will implement its guarantee program on no more than a demonstration basis in those years. We feel that the lack of a substantial track record would make it difficult for the Bank to sell debt on advantageous terms in these years. Sound business practice would thus lead it to look solely to its equity capital as a source of funds. We therefore ask that the Bank's authority to make or guarantee loans be limited to $40 million in FY 1979 and $100 million in FY 1980. The requested ceiling will allow the Bank to lend its capital while keeping a reasonable reserve for losses and for continuity of operations into FY 1981.

Salaries and Expenses of the Bank

The statute authorizes funds for the Bank's administrative expenses. Our request would chiefly cover the costs of establishing and operating the Bank's direct loan program. Such costs include hiring and training personnel, designing and implementing loan procedures, acquiring and remodeling office space, and the like.

Let me stress here that our request for administrative expenses reflects assumptions about the Bank's structure upon which its Board of Directors will ultimately decide. We have assumed, for example, that the Bank and its Self-Help Office will share many overhead services in order to secure cost efficiencies and that the bulk of these shared services (performed by roughly fifty full-time employees) would best be located in the Bank proper. We have also assumed that the Bank and the Self-Help Office will each maintain a separate field staff of credit analysts.

The bank will have no funds at all until it receives a FY 1979 appropriation. I therefore urge that you expedite treatment of the FY 1979 request.

Capitalizing the Self-Help Development Fund

The Self-Help Development Fund is designed to promote the growth and development of cooperatives that cannot obtain sufficient funds from other sources, particularly cooperatives that serve low-income people. The Fund's capital advances are well suited for achieving this objective. They will satisfy the need of many cooperatives for capital infusions that are subordinated to ordinary debt.

The statute requires that applicants present an acceptable plan for replacing capital advances with equity within thirty years. It also requires that advances bear interest at a

rate determined by the Bank's Board of Directors. All interest income and repayments of principal will be redeposited in the Fund's capital account. The requested capital appropriations will enable the Fund to assist cooperatives on a significant scale in fiscal years 1979 and 1980.

Salaries and Expenses of the Self-Help Office and the Technical Assistance Program

Our request for the expenses of this Office is separate from our request for the expenses of the rest of the Bank. It covers the cost of setting up and operating both the Office's capital advance program and its technical assistance program. It also covers the Office's share of the cost of services provided to it by the Bank.

The Office's technical assistance program will aid cooperatives with special needs, particularly those serving low-income people. For many cooperatives, technical assistance is the most important type of aid. Such assistance could include training in management, bookkeeping, financial planning, contracting, serving on a board of directors, and membership education. It could also include training in skills relevant to a cooperative's particular line of business, such as produce buying for food cooperatives, retail marketing for retail cooperatives, or health care management for health care cooperatives. In many cases the Office may recover all or part of the cost of assistance by charging fees.

Personnel

Let us turn briefly to the question of personnel. We believe that the Bank will be able to operate effectively and economically in fiscal years 1979 and 1980 with the authority to hire 166 full-time employees. We have assumed that roughly 101 of these employees will work under the direction of the Bank's president and that roughly 65 will work under the direction of the Self-Help Office's Director. We have further assumed that roughly fifty of the employees working for the President and roughly eight of the employees working for the Director will perform services for the entire Bank on a shared-cost basis.

This arrangement would help secure the cost savings sought by Congress in consolidating the Office within the Bank. I suggest, however, that the Bank should have discretion to modify this structure within the overall personnel limit of 166 full-time employees.

* * *

Thank you, Mr. Chairman and members of the Subcommittee for your attention. I will be happy to answer any questions you may have.

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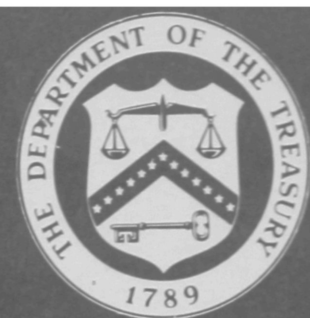

For Release Upon Delivery
Expected at 10:00 a.m. E.S.T.

Statement of
Donald C. Lubick
Assistant Secretary of Treasury for Tax Policy
Before the
Senate Committee on Finance
Subcommittee on Taxation and Debt Management
March 12, 1979

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear again before this Subcommittee to discuss the important income tax question of the appropriate tax treatment of appreciated property passing at death.

The Tax Policy Question

Before the Tax Reform Act of 1976 the basis of property acquired from a decedent was its estate tax fair market value. This rule is commonly called "step-up" in basis. The effect of step-up is to forgive forever the collection of any income tax on appreciation that has accrued in property held by an individual at death.

The enactment of carryover basis by section 2005 of the Tax Reform Act of 1976 has prompted volumes of comment that obscure the basic income tax issue carryover basis was designed to address. It is appropriate, therefore, to begin by identifying this issue.

To us the issue is not the workability of the 1976 carryover rules -- we shall later in our statement elaborate changes that will solve the technical problems under the 1976 Act. The issue is instead whether income tax liability on gains accrued by a decedent at his death are to be entirely and irrevocably forgiven. The defenders of the pre-1976 step-up rule must make a case to justify going back to

that result, other than simply that it existed before 1976. The Administration is committed to the principle that income tax on appreciation accrued at death should not be forgiven.

<u>Forgiveness is Unsound Income Tax Policy</u>

As a matter of income tax policy step-up is unsound for at least four reasons.

1. <u>Horizontal and vertical inequity</u>. Step-up discriminates arbitrarily among taxpayers and creates significant horizontal and vertical inequities. This can be illustrated by a simple example.

Let us start by assuming that no estate tax is imposed on the transfer of property at death. Further, assume that on the same day two taxpayers, A and B, each bought shares of stock in the same corporation for $10,000. A and B decide to sell when the stock is worth $110,000. Each would pay a capital gains tax of 25 percent on any recognized capital gain. A goes into his broker's office and sells his shares. He walks out into the street and meets his friend B who is about to go into the broker's office to sell his shares. They engage in animated conversation about what each will do with his net after-tax proceeds of $85,000 and fail to observe a speeding vehicle which strikes and kills them both.

A sold his stock before he died.[1/] He realized a capital gain of $100,000 upon which an income tax of $25,000 is due. His heir is left with $85,000 after the tax is paid.

Compare B, who has died before he could sell his shares. The shares pass to his heir with a new basis of $110,000. B's heir can immediately sell the shares for that price and pocket the entire $110,000.

Accidental, untimely death has caused A's heir to receive $85,000 and B's heir to receive $110,000. The result gives an unjustifiable advantage to B's heir.

Some assert that the income tax problem so glaringly highlighted by the example does not really exist because the

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1/ For purposes of illustration the technical question of when a sale of stock is complete is ignored.

appreciation in the shares owned by B is subject to estate tax. If this assertion is true, the net amount received after payment of both income and estate tax should be the same for A's heir and B's heir.

To test the assertion, assume that the shares or their proceeds in the estates of A and B are both taxed at a 30 percent bracket. A's estate after payment of income tax has assets of $85,000. After the further payment of $25,500 in estate tax, A's heir receives $59,500. On the other hand, B's estate has assets of $110,000. When the shares of stock are sold to pay B's estate tax liability of $33,000, B's heir receives $77,000, $17,500 more than that of A. The combined income and estate tax burden on B's heir is reduced by about 35 percent from the burden on A's heir.

This example demonstrates two basic facts. First, the estate tax and the income tax are two separate tax systems. The estate tax applies to the transfer of property, the income tax to the receipt of income. The estate tax is not a surrogate for the income tax. It applies to wealth accumulated after payment of income tax as well as to wealth that was not subject to income tax.

Second, the example demonstrates the disparate income tax treatment which can occur solely due to the timing of capital gain recognition. Thus, step-up permits those who are able to accumulate wealth in the form of unrealized appreciation to pass on that wealth free of income tax. Those who have recognized capital gains, as well as salaried individuals, can pass on only that which is left after income tax has been paid. Only the wealthiest of American taxpayers are in a position to live comfortably solely on dividends, rents and interest derived from appreciating assets they are rarely forced to sell. No policy justifies granting this segment of society an income tax advantage over the vast majority who are not in this enviable and privileged position.

This is not an extreme or hypothetical situation. Any tax practitioner can recite from his own experience instance after instance of advice by him to his clients to retain assets that would otherwise be sold primarily to secure forgiveness of income tax at death.

Several recent court decisions demonstrate the magnitude of the problem. In Estate of David Smith,[2/] the Court found the value of scrap metal owned by the decedent to be $2.7 million. Its basis was almost zero. Under step-up, virtually $2.7 in appreciation passed to the decedent's heirs free of income tax. In Estate of Henry,[3/] the taxpayer made gifts of marketable corporate stocks totalling $6.7 million with a basis of $115,000. The untaxed appreciation was almost $6.6 million. In Owen v. Commissioner,[4/] the taxpayer gave marketable American Express Company stock worth $5.2 million with a basis of $1,200. Virtually the entire $5.2 million passed free of income tax. In Bradford v. Commissioner,[5/] property worth $2 million with a basis of $283,000 was the subject of the gift. Over $1.8 million of appreciation passed income tax free. In Johnson v. Commissioner,[6/] the property given was worth $500,000; its basis was $10,800. Almost $490,000 of appreciation passed income tax free.

This phenomenon is not restricted solely to those with inherited wealth. As noted in a recent article in Fortune magazine, "there are dozens -- perhaps even hundreds -- of individuals who have amassed fortunes of $50 million or more in privately held companies."[7/] As the article shows, the initial investment in these enormously successful enterprises is nominal when compared to their current worth.

The impact of forgiveness of income tax at death is more significant as estate size increases. Table 1 demonstrates how estimated appreciation rises as a percentage of the gross estate as estates increase in size.

2/ 57 T.C. 650 (1972), Aff'd 510 F.2d 479 (2d Cir. 1975). cert. denied 423 U.S. 827

3/ 69 T.C. 665 (1978)

4/ T.C.M. 1978-51

5/ 70 T.C. 584 (1978)

6/ 495 F.2d 1079 (6th Cir. 1979)

7/ "In Search of the Elusive Big Rich", Fortune February 12, 1979, 12.

Table 1

Appreciation as a Percent of Gross Estate by Size of Gross Estate

(1979 Levels)

Size of gross estate	Gross estate	Appreciation including personal residence: Amount	Appreciation including personal residence: As a percent of gross estate	Appreciation including personal residence: Average per return	Appreciation excluding personal residence: Amount	Appreciation excluding personal residence: As a percent of gross estate	Appreciation excluding personal residence: Average per return
($000)	(... $ millions	....)	(.. % ..)	(dollars)	($mil.)	(.. % ..)	(dollars)
Under 175	$25,183	$4,386	17.4%	$18,000	$3,242	12.9%	$13,300
175 - 200	3,291	633	19.2	35,900	479	14.6	27,200
200 - 300	9,037	1,800	19.9	48,200	1,375	15.2	36,800
300 - 500	9,215	2,013	21.8	83,000	1,609	17.5	66,300
500 - 1,000	9,774	2,280	23.3	158,500	1,888	19.3	131,300
1,000 - 2,000	7,082	1,739	24.6	335,100	1,459	20.6	281,110
2,000 - 3,000	3,179	821	25.8	622,400	722	22.7	547,400
3,000 - 5,000	3,101	812	26.2	990,200	708	22.8	863,400
5,000 - 10,000	3,057	833	27.2	1,876,100	752	24.6	1,693,700
10,000 and over	3,365	1,153	34.3	7,161,500	1,114	33.1	6,919,300
Total	$76,284	$16,470	21.6%	$47,700	$13,347	17.5%	$38,600

Office of the Secretary of the Treasury
Office of Tax Analysis

March 8, 1979

In fact, over 75 percent of appreciation is found in estates of over $175,000, which comprise less than 4 percent of decedents dying annually.

2. Revenue loss. Step-up results in a significant revenue loss. Under step-up, an estimated $20 billion in accrued appreciation passes untaxed annually. The income tax on this $20 billion is not just foregone in the year of a decedent's death. It is permanently and irrevocably forgiven.

3. Economic distortions. Step-up also creates serious adverse economic effects. The opportunity entirely to avoid income tax on appreciated assets by holding those assets until death distorts capital mobility by inducing individuals to retain assets solely to obtain this benefit. The inducement to hold assets to avoid the payment of income tax is referred to as "lock-in".

It is almost impossible to quantify the amount of wealth that is "locked-in". This is because "lock-in" is a negative phenomenon. It occurs when sales otherwise dictated by sound investment strategies do not occur. Of course, the decision not to sell may involve other considerations which cannot be separated from tax-induced "lock-in". Nonetheless, to the extent the income tax system can be said to cause "lock-in", step-up is a major source of that "lock-in". Those whose estate planning takes step-up into account, and plainly this includes many elderly taxpayers and most taxpayers with large accumulations of unrealized appreciation, will inevitably find their decision whether to hold or sell affected by this provision.

Congress in 1978 relied upon revenue from higher sales volume to justify increasing the capital gains exclusion to 60 percent. The "lock-in" effect of step-up will undermine the goal of the reduced capital gains rates enacted by the Revenue Act of 1978. The purpose of the reduced capital gains rate was to unlock capital in the form of unrealized appreciation in assets that were not being sold because of the allegedly excessive tax burden imposed on the sales proceeds. This goal will not be met if taxpayers have the opportunity to avoid tax entirely by holding appreciated property until death.

"Lock-in" can best be reduced by treating death as a recognition event. If unrealized appreciation were taxed at the current long-term capital gains rates, a significant amount of the "lock-in" effect would be eliminated.

As to "lock-in", carryover basis is a second best approach. It somewhat reduces the "lock-in" effect for investors concerned with estate planning, since complete forgiveness is eliminated. However, if the property continues to appreciate in value, the capital gains tax would be greater when the heirs consider selling, and then their "lock-in" would be somewhat increased. Thus, "lock-in" would be decreased for some but increased for others. The net effect on aggregate "lock-in" cannot be determined fairly.

4. Disparate basis treatment for lifetime gifts and accrued but unpaid income items. Carryover basis for property acquired by lifetime gift has been the law since 1921. Similar treatment has existed since 1942 even in the case of property passing at death that consists of compensation, pension benefits and unpaid installment obligations from the disposition of property. Yet, most property acquired by gift at death received a new basis. Lifetime and deathtime transfers should be treated similarly for income tax basis purposes.

The Shortcomings of Forgiveness are Not Newly Recognized

The case against forgiveness on the grounds of inequity, revenue loss, adverse economic effects and structural inconsistency is overwhelming. It is not surprising that these deficiencies have long been recognized and that a number of responsible proposals to cure the problem were suggested prior to the 1976 Act.

In 1963, while proposing that the gain on the transfer of a decedent's assets at death be subject to income tax at that time, Secretary Dillon stated:

> The prospect of eventual tax-free transfer of accrued gains with a stepped-up basis equal to the new market value ... distorts investment choices and frequently results in complete immobility of investments of older persons .... The reduction in capital gains rates alone would not effectively deal with the lock-in problem. Without this broader, more equal capital gains tax base, there would be no justification for lowering capital gains tax rates.[8/]

8/ Hearings on President's 1963 Tax Message Before the House Comm. on Ways and Means, 88th Cong., 2d Sess., 49 (1963).

While President Kennedy's 1963 proposal was not adopted, the House Ways and Means Committee did at one point tentatively adopt carryover basis as a solution.

The 1969 Treasury Department Tax Reform Studies and Proposals also included a proposal to subject to income taxation the appreciation in the value of assets transferred at death.[9/] The proposal was addressed to the following deficiencies of step-up:

> [I]nequality in the income tax treatment of people who accumulate their estates out of currently taxable income as compared to those who accumulate estates by means of unrealized capital gains.
>
> At least $15 billion a year of capital gains fall[ing] completely outside the income tax system.
>
> [U]ndesirable economic effects because of the resulting "lock-in" effect.[10/]

By 1976, Congress was prepared to address the issue. Forgiveness was repealed and carryover basis was substituted, effective for estates of decendents dying after 1976. The reasons for change were:

> Present law [step-up] results in an unwarranted discrimination against those persons who sell their property prior to death as compared with those whose property is not sold until after death. Where a person sells appreciated property before death, the resulting gain is subject to the income tax. However, if the sale of the property can be postponed until after the owner's death, all of the appreciation occurring before death will not be subject to the income tax.
>
> This discrimination against sales occurring before death creates a substantial "lock-in" effect. Persons in their later years who might otherwise sell property are effectively prevented from doing so because they realize that the appreciation in that asset will be taxed as income if they sell before death, but will not be subject to income tax if they hold the asset until

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9/ U.S. Dept. of Treasury, Tax Reform Studies and Proposals, 81st Cong., 1st Sess., 28, 42, 107-111, 331-340 (1969).

10/ *Ibid.* at 331.

their death. The effect of this "lock-in" effect is often to distort allocation of capital between competing sources.11/

A problem of substantial magnitude existed under step-up, the problem had long been recognized and it was resolved in an acceptable manner through the enactment of the carry-over basis concept. Technical problems with the statutory provisions that have surfaced since enactment should not obscure this achievement.

The Arguments For Step-Up Forgiveness

The 1976 repeal of step-up prompted a large volume of comment. It is important to examine carefully the substance of this comment to identify legitimate questions.

1. Death is a "tax loophole". The assertion has been made that those who favor repeal of step-up view death as a "tax loophole." The issue is whether property which passes at death should be treated the same as property which passes *inter vivos*. It is not true that the repeal of step-up discriminates against people who hold property until death. Deferral of taxation aside, it simply places those individuals on an equal income tax footing with those who have not accumulated wealth in the form of unrealized appreciation and held it until death.

2. Repeal of step-up will result in a new tax. Some assert that the repeal of step-up constitutes a new tax. This is untrue. There is no new tax imposed if step-up is repealed; rather certain property on which deferred income tax was forgiven now becomes subject to that tax. This is not a semantic point. As the Chairman of this Subcommittee stated in a recent address before the New York State Bar Association, "tax laws should apply equally to all taxpayers." When they do not, they should be changed. Forgiveness results in taxpayers who have sold property before death being treated differently than those who did not. The result is unequal application of the laws.

3. The expectancies of those who relied on step-up must be protected. It is alleged that the repeal of step-up

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11/ House Committee on Ways and Means Report, Estate and Gift Tax Reform Act of 1976, H. Rep. No. 94-1380, 94th Cong., 2d Sess., 36-37 (1976).

dashed the expectations of those who relied on that provision in making investment decisions. The answer to real, and not imagined, difficulties regarding expectations that should be protected lies in appropriate transition rules. The original carryover basis provision in H.R. 14844 contained no transition relief. To protect legitimate expectations, the transition rule, known as the "fresh start" adjustment, was added by the Conference Committee. If that provision does not achieve its intended purpose, it is appropriate to reexamine it and make necessary modifications. But it is totally inappropriate to retain step-up forgiveness because the transition rule may require adjustment.

4. Repeal of step-up results in tax on inflation gains only. Some assert that step-up should be retained because much of the appreciation that would be subject to tax under an alternative system is attributable to inflation. The amount of appreciation involved in the gifts of property noted in the cases cited earlier demonstrate that this is not the case. There is no way that inflation can account for increases in value of that magnitude. But even if it were true, the simple example of A and B provides a total response. Each was equally affected by inflation and yet the heirs of each receive different amounts. While the effects of inflation are a matter to which the Administration is devoting considerable attention, it is neutral in this context.

5. Death is an inappropriate time to impose income tax. Some of the comment over repeal of step-up has as its core the notion that it is inappropriate to treat the involuntary event of death as an income tax recognition event. This argument does not lead to the conclusion that forgiveness is correct. Rather, if accepted, it would lead one to adopt carryover basis. This is because under a carryover basis system no income tax is imposed until an appreciated asset is sold. Moreover, the argument ignores the fact that death is one of the few times an accounting of wealth is made for tax purposes.

6. Repeal of step-up is unnecessary because unrealized appreciation is subject to estate tax. As I noted earlier, some assert that it is not necessary to subject unrealized appreciation to income tax because that unrealized appreciation is included in the decedent's estate and is subject to estate tax. This argument is rebutted by the simple example of A and B, one of whom sold his assets before death and the other who did not.

It has been suggested that, to the extent the argument against step-up forgiveness involves concern over the revenue loss attributable to the $20 billion dollars of unrealized appreciation passing untaxed annually, the solution is simply to raise estate tax rates. However, there is nothing like the uniformity in the ratio of appreciable assets to estate size, between taxpayers having the same estate size, that would be required before consideration could be given to substituting an estate tax increase for repeal of step-up.

A simple increase in estate tax will not result in fairness for income tax purposes between estates of the same size.

If it is believed that carryover results in too great an overall tax burden, it would be fairer to lower estate tax rates for all estates than to forgive income tax liability. If the Subcommittee desires, we would be happy to work with it to analyze this question. But the question of overall tax burden cannot be permitted to obscure the basic issue forgiveness raises: the equitable income tax treatment of those who have realized gain prior to death as opposed to those who have not.

7. <u>Carryover basis or subjecting unrealized appreciation to graduated income tax rates at death is regressive</u>. The Committee may hear testimony that the 1976 carryover basis provision is regressive by estate size. A basis adjustment is made to account for the fact that estate tax has been paid on property that has been valued without taking into account the contingent income tax liability on unrealized appreciation. Because of this basis adjustment the increase in overall tax for a given amount of appreciation will decline as the size of the estate increases. This is said to be regressive.

It is, of course, true that for estates in the 70 percent bracket, forgiveness of income tax only lets the heirs keep 30 cents for each dollar of income tax that is avoided while in the 40 percent estate tax bracket the advantage of step-up forgiveness is 60 cents on the dollar. Carryover merely eliminates the advantage to the extent it exists. There is no more regressivity here than in the allowance of a deduction for administration expenses that is worth 70 cents on the dollar to a very large estate and nothing to a very small estate. Yet the deduction is necessary to measure the estate transferred. The adjustment

simply assures that the estate tax applies to the correct transfer tax base, the gross estate less the amount of accrued income tax liability.

8. Any system other than step-up cannot work because proof of basis problems are insurmountable. This Subcommittee has previously received testimony and submissions to the effect that no system which relies upon the need to determine the basis of assets transferred at death can possibly work. The assertion is that either taxpayers do not keep adequate records of the acquisition cost of assets during their lives or if they do, those records somehow disappear at death.

This problem did not deter Congress when it first enacted the income tax. The basis of property held on March 1, 1913 was its value on that date or historical cost and the income tax system managed to work. The Canadians adopted a similar basis rule when they first treated gifts and deathtime transfers as recognition events. Their system has not posed significant basis determination questions. Both Canadian government authorities and private practitioners inform us that the issue of proof of basis has not even been a matter of public discussion. Moreover, carryover of basis has not caused significant difficulties for property transferred by gift or items of income in respect of a decedent passing at death. These carryover provisions have existed since 1921 and 1942 respectively. Nonetheless, we understand that the American Bankers Association, and perhaps others, will submit a number of actual cases in which, during the period carryover basis appeared to be in effect, executors had difficulty determining the basis of assets. We look forward to examining this report so that we can determine independently the scope of this problem and suggest appropriate solutions.

Notwithstanding the data which may be submitted, several fundamental points are relevant. First is the necessity of recordkeeping to provide for the case of a lifetime sale or other disposition of property. Second is the question of the types of assets for which it is reasonable to assume taxpayers retain cost records. Third is the standard to which taxpayers who acquired assets prior to the effective date of any new system should be held. Once these three issues have been examined it is possible to design a system which takes into account legitimate record keeping problems.

Under our income tax system (and for gift tax reporting purposes), an individual who acquires property should retain cost basis information. That information will be relevant if that property is sold or given away. Even under step-up forgiveness, records were unnecessary only if a taxpayer knew with absolute certainty that the particular asset would be held until death. Since most taxpayers pay for assets they acquire, and all taxpayers are interested in reducing tax on sale, it is in their interest to retain or obtain cost records. Otherwise secondary evidence will be needed to establish some basis or the entire sale price will be taxable.

We believe most taxpayers recognize this and do retain cost records for most assets. Whether those records are readily accessible or in a form which could be understood by others is a different question and one to be examined in the context of transition relief. However, it is simply not true that the vast majority of taxpayers of this country fail to keep records as to the acquisition cost of the vast majority of assets they acquire, especially investment assets held by the wealthiest 2 percent of taxpayers.

The proposition that record keeping problems should control whether tax is imposed on an otherwise clearly taxable event would, if carried to its logical extreme, mean that only "easily measurable" income should be taxed. It also implies that the determination whether income is "easily measurable" rests entirely with the taxpayer. Thus, the taxpayer can, in his own discretion, control whether sufficient records exist to determine his income tax liability. If he fails to maintain records, income becomes hard to measure and hard to measure income is not subject to tax. Forgetfulness should not be blessed with forgiveness.

Records regarding the acquisition cost of closely held corporation stock may be difficult to find but should be capable of reconstruction. In the case of partnerships and subchapter S corporations past income tax returns will provide basis information. For those who are engaged in sole proprietorships, past income tax returns will show the basis of depreciable assets.

If acquisition cost records do not exist with regard to investment real estate, it is usually possible to recreate or estimate basis by a number of methods. For example, many deeds state the purchase price of real estate. Transfer tax

stamps or local property tax assessments may also provide guidance. The basis of marketable securities can be estimated by reference to market quotations on or about the acquisition date.

We recognize, however, that record keeping problems do exist with regard to certain types of assets and that it is necessary to address these problems in designing appropriate relief. For example, many taxpayers may fail to retain records of the cost of items of tangible personal property such as furniture, clothing, collections of nominal value and the like. Many taxpayers also fail to keep accurate records with regard to improvements to personal residences.

Problems with records for property acquired prior to the effective date of the repeal of step-up must be distinguished from problems which may occur thereafter. Congress must assume that any justification for failure to keep records disappears once taxpayers are on notice that assets acquired after the effective date are subject to the new statute. Step-up cannot be retained just because there are fears that taxpayers will not keep records.

Therefore, the record keeping problem the Subcommittee should focus upon is that of basis information for assets acquired prior to the effective date of the repeal of step-up. Our experience under the income tax when originally enacted and the recent experience of the Canadians indicate that this should not be a serious problem. Moreover, the problems that do exist should be alleviated by the "fresh start" concept adopted in 1976.

Under this approach, the basis of property in the hands of an heir is the greater of historical cost or value on December 31, 1976. Two rules exist to determine value on December 31, 1976. If the property was a marketable security, the value is the market quotation. The December 31, 1976 value of all other property is determined by pro-rating appreciation from the date of acquisition to the date of death on a daily basis and adding to the acquisition cost that portion of the appreciation attributable to the holding period prior to December 31, 1976. However, under the 1976 rules, the fresh start adjustment is available only for purposes of determining gain. Thus, historical cost is also important because it is the only basis upon which a loss may be recognized.

Under this system of transition relief records play an important role. However, a few simple changes should resolve the record keeping problem for the vast majority of taxpayers. For example, consider the following. The present $10,000 personal and household effects exclusion would be increased to $50,000, property subject to the exclusion would be expanded to include tangible personal property which was a capital asset in the hands of the taxpayer, and excluded assets would be determined in ascending order of value as reported on the decedent's estate tax return. The basis of property acquired prior to the effective date would continue to be the greater of acquisition cost or the fresh start value but the fresh start value would be available for determining both gain and loss. Fresh start value for marketable securities would be the market quotation on the relevant valuation date. Certain classes of property the value of which will not increase after the valuation date (such as notes or selected types of preferred stock) would be treated like marketable securities for this purpose. All other property would have the fresh start value determined by use of a generous formula starting with estate tax value and assuming annual appreciation of 6 percent, subject to a minimum in any case of 25 percent of estate tax value. That is, the fresh start value would be determined by dividing estate tax value by a number from a table which would contain the appropriate discount rate. The discount back formula would replace the present time apportionment method.

In this system, historical cost is relevant only if it exceeds fresh start value. It is not needed to determine fresh start value as is presently the case.

It is true that historical cost may exceed fresh start value and executors may still feel pressured to find historical cost. In the case of almost all property, however, it should be possible for the executor to make an educated judgment as to the likelihood of historical cost exceeding fresh start value. Where that is probable, we also believe satisfactory information to recreate basis will exist. However, if the Congress feels that finding historical cost, even after taking into account this generous fresh start relief, is still a burden it could simply say that the basis of assets acquired prior to the effective date will be equal to the fresh start value.

A solution such as that set forth above should eliminate proof of basis problems for the bulk of the examples which

will be presented to the Subcommittee for assets acquired prior to the effective date. As for assets acquired after the effective date, taxpayers are put on notice of the need to retain basis records. Special relief is provided for household effects and the like.

In short, we believe the proof of basis issue is a red herring. We agree with the Special Tax Counsel to the Trust Division of the American Bankers Association, Richard B. Covey, who stated in a recent article that objections to carryover basis on the ground that proof of basis problems were so severe as to merit a return to step-up were "premature, at least until a reasonable trial period has passed."[12/]

9. Carryover basis delays the probate of estates, inordinately increases the cost of estate administration and presents irreconcilable fiduciary conflicts. The allegation is made that carryover basis, solely by introducing a new concept to be taken into account during estate administration, frustrates efforts of the probate bar to simplify the administration of estates. It is true that any departure from step-up introduces additional complexity. However, if the proposals we suggest are adopted this complexity will not exist for 98 percent of the estates coming into existence annually. The question is whether carryover basis unduly affects and delays administration of the estates of the remaining 2 percent.

If our proposals are adopted, much of the anticipated difficulty and cost of administration of carryover basis is eliminated. The aggregate cost of compliance will be insignificant compared to the revenue it generates and the increased income tax equity it produces.

It is also alleged that carryover basis improperly intrudes in estate administration by creating an entirely new set of considerations to be taken into account in distributing assets to various beneficiaries. While by no means certain under applicable state law, it is possible that a fiduciary may have to take income tax basis into account in making distributions.

If this is an assertion that fiduciaries are incapable of administering estates when they must take tax consequences into account, it is a curious one. Estate planning and administration is replete with tax considerations. The tax literature abounds with learned discussions of various minimization techniques. Entire books have been written on

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12/ Covey and Hastings, "Cleaning up Carryover Basis," 31 The Tax Lawyer 615, 695 (1978).

subjects such as the marital deduction. Law schools devote entire courses to estate planning and administration. Many wealthy taxpayers, who also happen to be those who would be affected by the repeal of step-up, often pay substantial legal fees to tailor estate plans to minimize taxation.

If this argument is premised on the fact that property with bases different from estate tax value cannot be dealt with by fiduciaries, it is also rather curious. The real world is complicated for those administering large estates. Fiduciaries must already make choices which have both tax consequences and affect the net amounts received by beneficiaries and they are not clamoring to have these elections eliminated. For example, fiduciaries must decide whether to file a joint or separate income tax return for the year of the decedent's death; whether to claim expenses as estate or income tax deductions; whether to elect the alternate valuation date; whether to elect special use valuation; whether to elect to pay estate tax in installments; whether to distribute property in cash or in kind; whether to receive retirement benefits in other than a lump sum; the choice of a fiscal year; whether to accumulate or distribute estate income; which assets to sell and how to reinvest the sales proceeds; when to settle claims and when to terminate administration. Carryover basis considerations do not materially add to these decisions. Indeed, in the more sophisticated estate plans, decisions with regard to the administration of formula marital deduction clauses make the alleged carryover basis problems pale in significance.

The Choices

I have previously stated that the Administration is committed to the principle that income tax on appreciation in assets held at death should not be forgiven. The choices as to how to tax this appreciation are two: treat death as a recognition event for income tax purposes or provide that the decedent's basis carries over to his estate and heirs.

There are a number of principles that should be applied in making this choice. First, the system should be as simple as possible consistent with the principle that similarly situated taxpayers should be treated similarly. Second, the system should intrude as little as possible in the estate administration process. Third, where the system may produce hardships, such as liquidity problems, those issues should be identified and dealt with in a fair manner. Fourth, the treatment of lifetime and deathtime transfers should be the same.

Any system without step-up forgiveness is more complicated than a system with step-up. There is no question that forgiveness is simple. There is no need to determine basis and so long as an individual does not sell an asset, inaccurate or nonexistent records present no problems.

However, this argument proves too much. Nontaxation is always the simplest system and an argument as to simplicity can be made with regard to almost any taxing provision, including deductions or credits.

There is much to be said in favor of treating the transfer of property at death as an income tax recognition event. It achieves parity between taxpayers who sold property before death and those who did not, with those who held assets until death still retaining the advantage of tax deferral on unrealized appreciation. Such a system could be more simple than carryover basis because accounts would finally be settled at death. Alleged fiduciary problems encountered in taking into account potential income tax liability in connection with the distribution of property to various beneficiaries would be eliminated. The distortions of "lock-in" would be lessened. Finally, basis adjustments to account for estate tax attributable to unrealized appreciation would be eliminated.

The Treasury Department believes that treating a transfer at death as a recognition event is an entirely acceptable solution to the step-up problem. We have devoted considerable time over the last several months on the development of alternatives to implement such a system, including an examination of the two forms of "Additional Estate Tax" until recently favored by the American Bankers Association. If the Subcommittee indicates an interest in pursuing this course, we would be willing to supply these materials when we have completed our work on them.

I have also indicated that, in concept, carryover basis represents an acceptable solution to the forgiveness problem. However, we agree experience has shown that the 1976 Act statutory structure could be improved.

Recognizing this, Treasury has made a major effort to meet with interested professional groups and individuals to learn of their specific concerns and their suggestions for change. We have received valuable assistance from the American Institute of Certified Public Accountants, the Trusts and Estates Law Section of the New York State Bar

Association and individual members of the Special Carryover Basis Committee of the Tax Section of the American Bar Association, to name just a few. This hearing, we hope, will provide another opportunity for the public to suggest to the Subcommittee and Treasury their proposals for modifications.

At this time I should like to examine the complaints regarding the operation of the 1976 carryover basis provision that have been registered with the Subcommittee in prior hearings, and propose solutions to them. I shall divide my discussion of these problems into three areas, the basic statutory provision, the transition relief afforded by the fresh start adjustment and liquidity issues.

1. The Basic Statutory Provision

a. The provision is overbroad because it applies to the estates of many decedents who are not required to file estate tax returns. We recommend that in general, carryover basis would apply only to those estates for which estate tax returns are required. The basis for assets held by estates not required to file Federal estate tax returns would be determined under step-up. Executors of nonfiling estates would not, therefore, be concerned with the basis of any property included in the estate except, as under present law, items of income in respect to the decedent. This change would eliminate approximately 98 percent of decedents dying annually from the operation of carryover basis.

It has been alleged that this change is purely a political expedient and that subjecting only 2 percent of decedent's estates to carryover basis violates the principle that the tax laws should apply equally to all taxpayers. Carryover basis will indeed apply to a small segment of decedents dying annually, but that small segment is the segment that owns more than 75 percent of all appreciated assets.

An increase in the minimum basis from $60,000 to $175,000 necessarily accompanies this proposal. Thus, the minimum basis assures that equality of tax benefit is given to large estates as well as small. Moreover, we believe the allocation of the minimum basis should be changed so that it does not depend upon a formula. Rather, the minimum basis would be allocated in the discretion of the executor first to capital assets and then, if any minimum basis remains, to assets which would produce ordinary income in whole or part when sold by the estate or heir.

The change in the allocation method will provide some measure of liquidity relief in those instances where the executor must sell assets to meet estate liabilities. It also eliminates the necessity to recompute the allocation of the entire minimum basis if there is an audit adjustment to the value of the property in the estate.

Minimum basis would be calculated prior to the death tax basis adjustment. This reverses the order of computation under the present provision. The minimum basis will therefore constitute a floor to which the death tax adjustment can be added rather than a cap as is presently the case.

b. The amount of the "personal and household effects" exclusion is too small and the term is ambiguous. The present exclusion would be increased to $50,000. To eliminate definitional ambiguity and relieve executors of the task of choosing excluded assets, the exclusion would be available to all items of tangible personal property that were section 1221 capital assets of the decedent. Assets subject to the exclusion would be selected in ascending order of value as shown on the decedent's estate tax return. In addition to eliminating questions of fiduciary choice, this expanded exclusion will solve the proof of basis problem for many of those who own collections.

c. The present death tax adjustments are unduly complicated, are computed by reference to an incorrect rate and require recomputation for all assets if the value of one asset is changed on audit. A simplified single death tax adjustment would replace the three separate but interdependent adjustments required under present law. A percentage number would be taken from the estate tax rate table and applied to each item of appreciated property subject to estate tax. The percentage to be applied would be the highest tax rate to which the estate is subject before any credits are applied, except that if an estate does not have at least $50,000 of property subject to tax in that bracket the next lower rate would apply.

To illustrate, a taxable estate of $400,000 will be in the 34 percent bracket. Each item of appreciated property used to fund a taxable bequest would receive a basis increase equal to 34 percent of the appreciation in that property. The total federal estate tax payable on a $400,000 estate, after subtracting the $47,000 unified credit, is $74,800, or approximately 19 percent of the total estate. Yet, in this case, the adjustment would be 34 percent. Under the 1976 Act provision, the 19 percent average tax rate would have been used.

Where an estate is nontaxable because of the unified credit, an adjustment, based upon the estate tax rate schedule would nonetheless be allowed. The allowance of an adjustment in this case permits an ample adjustment for any state death taxes.

No adjustment would be made where the decedent's estate was not required to file a federal estate tax return. In that case step-up will apply.

The move to a single death tax adjustment, computed at the highest marginal estate tax rate, has been uniformly applauded as a major simplification by all with whom we have consulted. Indeed, Mr. Covey, has commented:

> . . . The Treasury approach ... is commendable and a major step towards simplifying the complex and defective section 1023(c) and (e) adjustments. When combined with the proposed $175,000 minimum basis and with a computation of minimum basis before rather than after the adjustment for estate tax on appreciation, a fair overall result is achieved even though no direct adjustment is given for state death tax. In effect an adjustment is given for state and foreign death taxes in amounts equal to the section 2011 or 2014 (or treaty) credits because the marginal federal estate tax rate is a precredit rate.[13/]

The proposal has been criticized, however, on the ground that it does not permit a basis adjustment for state death taxes that exceed the amount allowed as a federal credit. It is true that state death taxes in excess of the federal credit do not result in an additional basis increase. However, one would question whether it is appropriate to give a federal tax adjustment for state taxes in excess of the credit amount. Rather, if a state's death taxes are too high, the problem should be resolved by the state. Moreover, the adjustment is computed at the highest applicable marginal federal estate tax rate, and therefore may result in an over-compensation because much of the estate has been subject to tax at rates less than the highest marginal rate. In addition, the adjustment is available without regard to the amount of depreciated property in the estate.

13/ Covey and Hastings, "Cleaning Up Carryover Basis", 31 The Tax Lawyer 615, 647 (1978).

The most recent commentary of the American Bankers Association makes much of the failure to adjust for state death taxes. However, Mr. Covey makes the argument in opposition eloquently when he states, using New York as an example, that:

> The understatement of the basis increase for the New York estate tax on appreciation will most frequently occur when all of the appreciation is taxed in only one rate bracket for federal purposes. To illustrate, for a taxable estate in excess of $10 million with all appreciation taxed in the top rate bracket, the basis increase on the Treasury approach is $70 for each $100 of appreciation while under an exact method the increase would be $75 for each $100 of appreciation. If, however, the appreciation was taxed in two or more federal rate brackets, the federal basis increase under the Treasury approach would be overstated when compared with the result of an exact method. This point can be seen by taking estates of various sizes which are all appreciation. In such a case, the Treasury approach would exceed the basis increase under an exact method until the taxable estate exceeds $60,000,000. (Emphasis added).[14/]

Mr. Covey goes on to state:

> Major simplification would be achieved under the Treasury approach because the basis increase would in most cases not be "suspended." A change in the increase would be required only if as a result of the audit of the federal estate tax return the estate is moved up in a rate bracket.[15/]

While this adjustment is generous in most cases, this generosity does not significantly affect horizontal equity, achieves a fair result and is consistent with the principle that complexity should be avoided where it is possible to achieve a comparable result in a simple manner.

d. It is unnecessarily time consuming to require the death tax adjustment to be computed separately for every asset included in the decedent's estate. Since the death tax adjustment is a single percentage, it is simple.

14/ Ibid., 647-648.

15/ Ibid., 648.

Moreover, the executor would be permitted to elect to average the basis of similar items of property acquired at different times. For example, the basis of mutual fund dividend reinvestment shares or shares of stock of the same corporation acquired at different times could, at the executor's election, be averaged. The simplified single death tax adjustment would then be applied to the average basis rather than the actual basis of each share. This proposal would also simplify executors' decisions regarding the distribution of appreciated assets. All similar property would have the same basis and inherent gain would be the same.

e. Special rules are needed for personal residences. We propose two changes. First, if unused, the $100,000 personal residence gain exclusion would be available to the decedent's executor on an elective basis as a positive basis adjustment, without regard to the decedent's age but with the consent of a surviving spouse required. This would coordinate the 1978 Revenue Act changes with the carryover basis system. Second, an annual addition to basis (for example, $250), would be permitted for personal residences acquired after the effective date of the statute to account for improvements, unless a larger amount could be substantiated in any year. This would mitigate the record keeping problem for minor home expenditures.

f. The present reporting requirements are unduly burdensome. If the foregoing proposals are adopted, basis information reporting would be required only from executors of the less than 2 percent of estates subject to carryover basis. Penalties would be assessed pursuant to a negligence standard only.

g. The basis of carryover basis property remains uncertain until that property is disposed of in a transaction in which basis becomes relevant. A procedure would be created pursuant to which executors could achieve a final determination of basis, binding upon both the executor and the Internal Revenue Service, at the time of audit of the decedent's estate tax return. A number of the groups with whom we have consulted have suggested that such a procedure is essential to resolve basis uncertainties and simplify the long-term administration of carryover basis.

2. Transition Relief

a. The fresh start rule applicable to nonmarketable property poses insurmountable proof of basis problems. This question was addressed earlier. To reiterate, the

discount back rule of the Revenue Act of 1978 would be applied at a rate of 6 percent to determine the fresh start basis for all property held on December 31, 1976 other than marketable bonds and securities. The application of this formula could in no event result in a basis less than 25 percent of estate tax value. The present formula which apportions appreciation ratably on a day-to-day basis would be abandoned.

Historical cost would be important only if it exceeded the fresh start value. If this is deemed to impose undue burdens on executors, the discount back formula could be the sole method.

b. The fresh start adjustment unfairly discriminates against nonmarketable property, because its fresh start basis can never exceed estate tax value. It is true that the fresh start value of nonmarketable property cannot exceed estate tax value.

One solution is to provide a "national appraisal date" and permit the appraised value of property on that date to be its fresh start value. Congress specifically rejected this alternative in 1976 and we think it was wise so to do. Even if one believes in the veracity of appraisals, it is questionable whether all taxpayers should be put to the expense of obtaining such appraisals when it is not clear that the appraised property will be held until death. Moreover, in the real world, even contemporaneous appraisals are the subject of substantial dispute. It is, therefore, reasonable to anticipate administrative problems when the validity of an appraisal is examined many years in the future. These facts lead to the conclusion that the appraisal technique is not appropriate. The discount back formula is a reasonable alternative.

Certain types of nonmarketable property would be treated as if they were marketable securities for purposes of this fresh start rule. There are assets, the value of which will not change substantially from the fresh start date to the date of death. It is unfair to subject these assets to fresh start value determination under a discount back formula. Therefore, we propose that nonconvertible, nonparticipating preferred stock be given fresh start value equal to its redemption price on the fresh start date.

In addition, the Secretary would be granted regulatory authority to devise alternatives to the discount back formula for assets which will not substantially appreciate in value after the fresh start date, such as nonmarketable notes, and assets the value of which could be readily ascertained as of December 31, 1976 by a method other than appraisal. An example of the latter is property subject, on the fresh start date, to a binding buy-sell agreement that has the effect of fixing estate tax value. The fresh start value would be determined by reference to the formula set forth in the agreement.

c. The fresh start basis should be available for purposes of both gain and loss. Treasury agrees. This change would eliminate the need to retain records of separate bases for "fresh start" property.

d. The fresh start adjustment should be calculated by reference to estate tax value. Again, Treasury agrees. Executors would not be required to establish date of death value as a computation base where the estate tax alternate valuation date is elected.

3. Liquidity Issues

Carryover basis itself does not cause liquidity problems. No tax is due in a carryover basis system until carryover basis property is sold. No family farm faces a tax liability from carryover basis until the farmland is sold. If liquidity problems exist, they arise because of the estate tax.

A large portion of the appreciated property held by estates is comprised of marketable securities and investment real estate. In the case of marketable securities there can be no liquidity problem. In the case of investment real estate, the estate tax will be imposed on the value of the property net of indebtedness. To the extent investment real estate is subject to estate tax, the net equity in the property should be sufficient to secure a loan sufficient to pay the estate tax.

Problems may exist where the investment property does not generate sufficient income to service a loan. We would be sympathetic to proposals to provide additional liquidity relief in these situations where there is demonstrated need.

Closely-held business interests and farms, which represent only 7 percent of the value of assets reported on estate tax returns, pose a somewhat different problem. In

the case of farms, special use valuation significantly reduces includible value for estate tax purposes. Liberal estate tax deferral provisions provide an opportunity to spread the payment of estate tax over 10 or 15 years for qualifying farms and small businesses. Finally, section 303 provides an opportunity to have closely-held stock redeemed at reduced capital gains rates. The combination of these provisions provides a significant measure of relief. However, we are willing to explore additional liquidity relief solutions for farms and closely-held businesses that will reduce or defer the payment of income tax on assets sold to pay estate tax.

Conclusion

The basic issue before this Subcommittee is the fairness of an income tax system which forgives income tax on appreciated assets passing at death. Forgiveness is unsound income tax policy. Those who would return to step-up should justify that step. They cannot be allowed to use technical complexity as a rationale. Technical problems can be solved.

It is the Administration's firm position that unrealized appreciation in property held at death cannot be permitted to escape income taxation. Either carryover basis or treating death as an income tax recognition event is acceptable.

We look forward to hearing the testimony of those individuals who will appear before you and to reading the written submissions of the others. We hope you will permit us to respond for the record to the testimony you will hear today and next week. To that end I ask that you hold the hearing record open for an additional two weeks to enable us to prepare that response.

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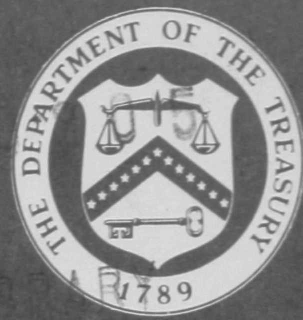

MAR 15 1979
TREASURY DEPARTMENT

FOR IMMEDIATE RELEASE
EXPECTED AT 9:30 A.M. EST
MONDAY, MARCH 12, 1979

STATEMENT BY THE HONORABLE C. FRED BERGSTEN
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

Mr. Chairman: I am pleased to appear before you today to present the Administration's proposals for authorization of U.S. participation in replenishments of resources for the Inter-American Development Bank, the Asian Development Fund and the African Development Fund.

The authorization requests for these three institutions total $4,019 million, including $2,543 million for callable capital subscriptions which do not entail budgetary outlays and $1,476 million for paid-in capital subscriptions and concessional funding which will eventually lead to budgetary outlays. They cover the U.S. share of the financing necessary to sustain lending operations of the institutions during the period 1979-1982. These requests require annual appropriations over a three to four year period beginning next year and provision has been made for the first of these appropriations in the FY 1980 Budget.

B-1450

Prior to concluding the negotiations on these three replenishment agreements, the Administration consulted actively with the Congress regarding U.S. objectives, and positions on all the key issues.

In the House, we were able to participate in formal hearings last April prior to the final negotiating sessions for the replenishments of the Asian Development Fund and the African Development Fund and, in December, just before the final negotiations for the increase in resources of the Inter-American Development Bank. These consultations were very helpful to us in carrying out and completing the negotiations. We hope they have laid the foundation for a common view between the Administration and Congress on these replenishments.

U.S. POLICY TOWARDS THE MULTILATERAL DEVELOPMENT BANKS

Before discussing the details of the individual replenishment proposals, I would like to set out the policy perspectives within which we view U.S. participation in the multilateral development banks. We think that this participation is particularly important for the conduct of U.S. relations with both developed and developing countries. In discussing each

of the replenishment proposals, I would like to relate our participation to specific countries and to the achievement of specific foreign policy objectives on a regional basis.

However, our relationships with the developing countries must be considered more broadly. They encompass major political, security, economic and humanitarian concerns. Indeed, U.S. support for economic growth and development in poorer countries is directly linked to meeting these fundamental concerns. Maintenance of the U.S. commitment to a constructive and cooperative program of international economic assistance is essential if we are to continue to provide that support on an effective basis.

The primary objective of U.S. foreign policy is to promote peace, prosperity, and cooperation among nations because the existence of these conditions in other countries contributes to the well-being of the United States itself. All of our foreign policy programs, including those for the multilateral development banks, have been designed to contribute to these objectives.

The more than one hundred developing nations contain the great majority of the world's population. They differ greatly among themselves in terms of culture, history, political systems and the level of economic development

that they have attained. Nevertheless, they all share one major aspiration: economic growth and development and material improvement in the lives of their people.

The less developed countries have moved to the forefront of world affairs. They are increasingly active in international political and economic organizations, and they have become much more effective in pursuing their national and regional interests. For several reasons, collectively, and in some cases, individually, they have assumed a much greater importance in U.S. foreign policy and national security considerations:

-- They are an important source of raw materials which are critical to the economies of the United States and other industrial countries.

-- They occupy strategic geographical positions.

-- They are growing users of atomic energy for peaceful purposes and a number of them have the capability for developing nuclear weapons.

-- They have military capabilities which can be used to initiate military conflicts affecting U.S. interests and having the potential of escalating into great-power confrontation.

-- Their growing populations and aspirations place greater demands on the earth's resources and environment.

Negotiations toward the solutions to these problems are complex and difficult, requiring a balancing of interests and a sensitivity to the requirements of developing countries. In implementing non-proliferation policy, for example, it is necessary to recognize that less developed countries have a legitimate and expanding requirement for energy. In order to combat international terrorism effectively, we must be able to count on the support of less developed countries in multilateral organizations such as the United Nations and in dealing directly with individual situations as they may arise. The Law of the Sea Conference now going on under the auspices of the United Nations requires the cooperation of less developed countries on a number of issues if we are to reach agreement and still protect interests of the United States relating to navigation, marine research, protection of the environment and exploration and exploitation of deep seabed mineral resources. In the context of these competing and conflicting interests on major international issues, the multilateral development banks provide the United States with a practical and effective way to work cooperatively with developing countries to help them meet their most basic aspirations.

Another major objective of U.S. policy is to encourage the integration of the developing countries

into the international economic system. The United States was instrumental in the establishment of this system shortly after the end of World War II, and we have worked hard to maintain its effectiveness. The system is based on the principles of free flows of trade and investment, and it has well served the United States and the world. Its continuation is necessary for our own progress and, we believe, for fulfilling the aspirations of the developing countries.

The multilateral development banks are an integral part of the international economic system. By responding to the developing countries' capital needs, they give those countries a stake in participating in and contributing to the continued growth and health of that system. Through their assistance to the economic and social progress of the developing countries, the banks foster a structure of cooperation between developing and developed countries characterized by mutual responsibilities and joint contributions to the health of the international economic and political system.

The continued economic growth and vitality of the developing countries is necessary if we are to have a sound and healthy American economy. In today's economically interdependent world, the prosperity of each nation depends on the prosperity of others.

In 1977, non-oil developing countries bought $24.5 billion worth of U.S. merchandise -- 30 percent of our total exports. In the agriculture sector, these exports amounted to $6.7 billion, and included wheat, rice and cotton. In the same year, our imports from these countries totalled $36 billion, one fourth of total imports. Our reliance on the developing countries for supplies of raw materials is striking, and includes tin, natural rubber, bauxite, manganese and other raw materials. These raw materials are necessary and, in some instances, vital to the health and progress of our economy. Indeed, we improve our economic prospects by encouraging and assisting rapid and equitable economic growth in the developing countries.

Over the longer run, the health of the U.S. economy will depend to a considerable degree on the reliable growth in supply of the products we need from the LDCs and LDC markets for our exports, as well as the flow of investment between us. One of the most effective means through which we can promote the growth and stability of the developing countries are the multilateral development banks.

DEVELOPMENT EFFECTIVENESS

The multilateral development banks have become the leading institutions in the field of international economic development. They raise resources for both

concessional and near market lending operations from many donor countries. As a consequence, they are able to operate on a significant scale and across the range of economic sectors. They are today the primary source of official development assistance. Their loan commitments in 1979 are expected to reach $12.5 billion, and their disbursements last year amounted to more than $5.5 billion.

This level of lending gives the MDBs important influence in recipient countries. Because of their apolitical character, and the fact that they operate on the basis of economic and financial criteria, the banks are able to encourage, in their continuous policy dialogue with borrowers, the adoption of appropriate economic policies so as to ensure good use of our money.

They do this by analyzing individual projects in the context of both the recipient's development program and priorities and trends in the world economy, selecting for funding only the soundest projects which are proposed. They also assist in the diversification of developing countries' economies by providing additional capital to sectors requiring it. Their policy advice is generally consistent with U.S. views and stresses the importance of market forces and an open international economic system.

Economic development is not only a matter of providing external capital. Although resources themselves are obviously required, economic development is primarily a matter of adopting sound economic policies and assisting in the establishment of effective public and private institutions in the developing countries.

In conjunction with their financial assistance, the banks strengthen local institutions and provide training for local officials through extensive programs of technical assistance. Within the economic systems which developing countries have chosen for themselves, the banks stress the role of market forces in the effective allocation of resources, the development of outward looking trading economies and the spreading of development resources to poorer people. The competence and international character of the staffs of the banks have established their reputation for rigorous and detailed appraisal of project proposals and programs. Therefore, their advice is often much more effective than that of individual bilateral donors, where political sensitivities may be involved.

The banks have also shown themselves able to respond to changing circumstances and new developmental initiatives. For example, they are now targeting a more

substantial proportion of their assistance to projects which directly reach the poor -- responding to needs for broadening the growth process, helping to satisfy basic human needs, and working toward better distribution of income, increased agricultural productivity and reduced rates of unemployment.

In response to our desire that they assist in increasing the productivity of the poor, the banks are placing increasing emphasis on employment creating projects, in connection with their efforts in both the agriculture and rural development sector and in urban-oriented industrialization efforts. Creation of additional jobs in the countryside can slow migration from rural to urban areas. Additional jobs in urban areas can ease pressures to emigrate to other countries.

Another high priority that we strongly support is the expansion of bank lending for energy development. In response to a request made at the Bonn Summit meeting, the World Bank has proposed a program to help solve the growing energy problems of developing countries and proposed an expanded lending program to do this. The United States has strongly endorsed the general provisions of that program, including Bank financing for geological and geophysical surveys and exploratory drilling, and an acceleration in lending for projects to develop and produce gas and oil.

Over the next few years, the Inter-American Development Bank will be devoting a large proportion of its lending to developing hydroelectric and geothermal potential in Latin America, and the Asian Development Bank has also embarked on a large lending program to finance the production of primary energy fuels. These MDB funds, moreover, will facilitate additional private investment in this critical area, thus helping to meet urgent requirements in the developing countries, and improving the oil supply and demand balance for the world as a whole.

Finally, the banks also contribute to the efficient use of scarce development assistance coming from many sources through their leadership and participation in the consultative groups and consortia which coordinate bilateral assistance efforts on behalf of numerous countries.

COST EFFECTIVENESS

The MDBs are a particularly cost-effective mechanism for providing economic assistance because they permit us to share the burden for providing this assistance

with other countries, and because they can mobilize private capital through bond offerings and cofinancing. What was once a predominantly U.S. foreign economic assistance effort has been transformed today into a much more broadly shared one. The overall U.S. share of subscriptions and contributions to the MDBs has shown a declining trend as the shares of other participating countries have increased. This reflects the growth and economic strength of other countries and their increased capacity to provide more resources for development. These include industrialized countries such as Germany amd Japan, OPEC nations, and some of the relatively more advanced developing countries such as Mexico and Brazil, who have increased their convertible currency contributions to the replenishment of the Inter-American Development Bank, to which I will turn in a few moments.

Participation in a multilateral framework means that the interests of donor countries are collectively represented. No one country can dictate the policies of the multilateral development banks. Because we share the same view of the objectives of the banks with most other member governments, however, and because we play a major role in each of the banks, their operations and policies have responded to our policy priorities. The two policy areas I just cited -- lending to the poor and energy development -- come to mind.

LEVERAGE FROM PRIVATE CAPITAL

The banks rely on the callable capital subscriptions of their members as backing for their bond issues in private capital markets, and use these borrowed funds for their harder term operations. Because of their solid record of financing economically sound and feasible projects, the MDBs have been able to increase the leverage of their callable capital to the point where only one out of every ten dollars of capital subscriptions is in fact paid-in. In the recent IDB replenishment, this level dropped to seven and one half percent. In the case of the World Bank, for example, the United States has paid in $884 million to capital which has supported, through burden-sharing and leverage, over $45 billion in gross lending. Thus, each dollar the U.S. subscribed has generated some $50 in Bank lending.

The banks also engage in co-financing operations with the private commercial banks. These have involved the purchase of shares in individuals MDB loans as well as complementary financing arrangements for MDB financed projects. These operations are very desirable, not only for their resource mobilization effect, but particularly because they provide a mechanism for the introduction of commercial bank

lending in the developing countries for development projects. Some of these countries have not yet established a firm international credit standing, and the involvement of the private commercial banks will permit these countries to enter the world financial system, paving the way for future decreases in reliance on official assistance to meet external capital requirements.

BENEFITS TO THE UNITED STATES

The operations of the MDBs provide substantial direct and indirect benefits to the U.S. economy, substantially above our contributions. These benefits stem from project related procurement of goods and services, bank administrative expenses in the United States, net interest paid to U.S. holders of bank bonds, and faster LDC growth resulting in the most rapidly growing market for U.S. exports. The total value of U.S. procurement alone since the inception of the banks has been over $8.3 billion, which exceeds U.S. subscriptions and contributions paid into the banks by $2.1 billion.

Increased financing to the developing countries permits them to increase their imports of investment goods from the United States and other developed countries directly. As a result of their increased investment, the developing countries are able to improve their living standards more rapidly, providing a growing market for the United States

and other exporters. This investment also helps developing countries produce raw materials the United States must import in order to prosper.

From the time of the banks' inception in 1946 to the middle of 1978, direct accumulated receipts by all segments of the U.S. economy have exceeded outflows to the MDBs by $2.4 billion. In addition, an econometric analysis which we have made shows that real GNP increased annually between $1.2 billion and $1.8 billion as a result of exports of U.S. goods and services to markets directly created by MDB financed projects in developing countries. This means that every U.S. dollar paid into the MDBs generated between $2.39 and $3.38 in real U.S. economic growth annually over the period.

U.S. participation in the multilateral development banks is not motivated primarily by these kinds of benefits. However, it is clearly a mistake to view our contributions to the banks as giveaways or economic losses to the United States.

LATIN AMERICA

The bulk of the financing contained in the proposal before you today is to replenish the capital and concesssional

windows of the IDB for the four-year period 1979-82. Our approach to this replenishment was based on the twin realities of Latin America's position in the world economy for the 1980s: impressive overall economic progress in most countries, but continued great needs in most of them. I would like to describe briefly the situation of Latin America as we see it, as a backdrop against which to outline the replenishment packages.

During the past decade, Latin America's rate of economic progress has outstripped that of other developing regions:

- -- Between 1965 and 1977, the gross domestic product of the region more than doubled in real terms to nearly $400 billion. This represents an annual growth rate of 6.1 percent -- compared with 5.1 percent for all developing countries, and about 3.9 percent for the developed countries.
- -- During 1973-1977, the region grew at an average annual rate of nearly 5 percent compared with only 2 percent for the OECD countries. It maintained impressive growth even through the world recession, cushioning the impact of the recession on the industrialized countries -- particularly the United States.

-- Latin American exports to the U.S. have tripled since 1965, reaching $25 billion in 1977.

-- Real per capita GNP in the region has increased by more than half since 1965. It now stands at $1100, as compared with a per capita GNP of $450 for the rest of the developing countries.

As a result, Latin America has become an increasingly significant participant in the world economy, as a trading partner and as a region with great investment experience and potential. Based on its sustained and substantial economic growth of the past two decades, Latin America has made the transition to a region with a global role of its own which is increasingly self sufficient. Individual Latin American countries have become advanced developing countries (ADCs) with a vital stake in the future of the world economy, in the successful operation of the international trade and monetary systems, in ensuring adequate rates of production and demand, and in assisting the poorest countries of the world in eradicating extreme poverty.

Mexico is one example of how a country which is critically important to the United States benefits from MDB activities.

Its importance to the United States stems primarily from geographical proximity to this country and the influence which this proximity can have on the political, economic, social, environmental and security aspects of American society. U.S. relations with Mexico are governed by two fundamental U.S. policy objectives:

-- Political stability and economic growth in a Mexico which is friendly to the United States.

-- Control of migration flows which could have potentially disruptive effects for the United States.

In addition, development of Mexico's hydrocarbon resources will increase the free world's supply of oil and provide Mexico with the revenue to increase domestic employment, thus reducing migration pressures on the United States. Finally, cooperation between our two countries is necessary for narcotics control and other border issues including sanitation, pollution control, and law enforcement.

Mexico does not receive concessional lending from the IDB. It has become, in fact, a donor to the FSO. It continues, however, to receive substantial amounts of market rate financing from the MDBs. In its most recent fiscal year, Inter-American Development Bank loans to Mexico totalled $238 million. President Carter, during

his recent trip to Mexico, visited an integrated rural development project which is being financed jointly by the World Bank and the IDB. The purpose of this project is to increase incomes and employment opportunities for poor people in rural areas of the country. In addition to the financial intermediary role which the multilateral development banks play in Mexico, they are also able to provide advice on investment plans which may help Mexico to use its petroleum revenues most effectively to attack unemployment and under-employment and redress social and economic imbalances.

Brazil is another example. It is important to the United States simply by the weight of its size and strategic position. Brazil is the world's seventh most populous nation, with the tenth largest economy. Its endowment of natural resources and agricultural capacity rivals that of the United States. Brazil's industrial growth over the past decade has transformed the country into a major exporter of manufactured goods, especially to other developing nations.

The U.S. and Brazil share major global interests: the maintenance of Western security, a healthy world economy, the avoidance of North-South confrontation, and Brazil's successful completion of the transition to

developed country status along with peaceful evolution toward a more equitable and politically open, pluralistic society, setting an example for other developing countries. Brazil's challenge for the future will be to maintain adequate growth to create the estimated 1.3 million jobs needed each year to keep pace with rising population, while devoting more resources and attention to improving the productivity and well-being of its poor. The multilateral development banks play a financial intermediary role in Brazil as they do in Mexico. In calendar year 1978, the IDB made loans to Brazil totaling more than $282 million. Like Mexico, Brazil is a donor to the convertible currency resources of the concessional lending fund of the IDB and has agreed not to borrow from those funds.

However, Latin America is not a homogeneous region. The varying levels of development and domestic resources in the individual countries cover a wide spectrum. And the progress of recent years has left enormous economic and social gaps through the hemisphere.

Latin America contains some of the poorest and least developed areas in the world. For example, the level of protein intake in Haiti is the lowest in the world,

and its caloric intake is next to the lowest. Infant mortality rates throughout the region are three times as high as those in the United States. Forty percent of primary school-age children and sixty percent of secondary school age children do not attend classes. Population increases outpaced agricultural growth in 1975 and 1976 although a moderate improvement occurred in 1977. The labor force is increasing at a rate of 2.8 percent a year, exacerbating an already difficult unemployment problem. Although the growth in average per capita income in the region has been remarkable, there are now more people, perhaps as many as 150 million, living in absolute poverty than there were a decade ago.

Notwithstanding the progress that has been made by the region as a whole, there are countries which have not shared in Latin America's overall progress and which continue to need substantial amounts of concessional resources. These countries have little access to private capital markets and a limited ability to assume debt at market rates. Their per capita incomes remain low by Latin American and global standards as well.

Thus substantial development challenges remain in Latin

America. Continuing self-help and structural change is crucial to development, but Latin America also requires a continuing flow of external financial resources to sustain the momentum of its economic and social development.

The United States has a keen interest in fostering the development and ensuring the stability of Latin America and the Caribbean. In economic terms, the importance of the region to the United States is obvious by the large flow of goods and services, technology and capital in both directions. In 1977, our exports to the Latin American region nearly reached the $20 billion mark, more than our exports to Japan and almost as much as those to the European Common Market. This export volume is projected to grow by 10 to 15 percent per year.

Since 1960 U.S. direct investment in Latin America and the Caribbean has doubled with a restructuring of that investment away from enclave investments in mining and petroleum toward manufacturing, trading and finance. These investments now exceed $20 billion, approximately two-thirds of all U.S. investment in the developing world. In 1977, Latin America and the Caribbean provided the following shares of U.S. mineral imports: petroleum, 26 percent;

iron ore, 23 percent; bauxite, 88 percent; copper, 40 percent. In addition, we obtain about 50 percent of our sugar imports, 80 percent of our bananas, and 70 percent of our coffee from Latin America.

THE INTER-AMERICAN DEVELOPMENT BANK

With U.S. support, the IDB has contributed significantly to the economic development of the region. In its nineteen year history the IDB has proven itself an innovative leader, continually finding new ways to strengthen the development impact of its activities, through its project financing and through its technical assistance in developing planning and programming. By December of 1978, the IDB had provided $13.0 billion of assistance from its own resources of which $7.1 billion came from capital and $5.9 billion from the FSO. For the IDB to continue to play its important role in assisting Latin America's development efforts, the resources of both the Bank's capital and the Bank's concessional window, the Fund for Special Operations (FSO) must be increased as their current convertible currency loan commitment authority will be depleted by mid-1979.

Economic development is the highest priority objective of almost every one of the countries of Latin America. Our participation in the IDB in support of the region's

development efforts is a key element in our efforts to win their cooperation on matters of common concern such as narcotics, migration, and obtaining needed energy and raw materials. The IDB also provides an institutional setting where we can encourage the advanced developing countries to undertake a larger part of the responsibility for the functioning of the international economic system. The increased contributions of these countries in this replenishment demonstrate their recognition of their increased strength and responsibility as participants in the system.

This increased responsibility will bring great benefits to the region. Greater involvement in management of the international economic system by the countries of the region will assure them of a larger voice in its future development, making them less dependent on decisions taken by others and more capable of determining the future of their economic relations with the rest of the world.

In essence, full Latin American participation serves to prevent other countries from making decisions that do not fully take account of Latin American interests. And because of the joint gains to Latin America and to us of a free, liberal international economic system, we both stand to benefit from the process of shared participation and responsibility.

The U.S. approach to the IDB replenishment negotiations had the following objectives:

-- to focus lending on the poorer countries in the region and to the poor people in all recipient countries;

-- to increase burden-sharing by both developed and developing member countries;

-- to reduce the paid-in portion of the United States and other donors subscriptions, consistent with maintaining the financial soundness of the bank.

With respect to the first objective, these replenishment negotiations significantly restructure the lending program of the IDB for the 1979-1982 period. In response to the economic realities of Latin America the number of countries which will tap the FSO for convertible currency loans will be reduced. Several borrowers have progressed sufficiently that they no longer need to turn to the FSO at all as a source of external capital. In addition to the five countries which had already volunteered not to borrow convertible currencies from the FSO during the last replenishment period, 1976-1978 (Argentina, Brazil, Mexico, Trinidad and Tobago and Venezuela), Chile and Uruguay will now no longer do so. IDB lending for the Bahamas and perhaps one other Caribbean country might also now be wholly from capital resources.

As as result, the annual size of the FSO lending program can now be smaller than during the last replenishment. We believe this to be a most appropriate step in the evolution of development finance whereby, as countries make economic progress and no longer need concessional resources, they can graduate to harder lending terms and the level of concessional assistance they receive can fall. The FSO replenishment will allow for $468 million in convertible currency loans per year, down from an average level for the 1976-1978 replenishment of $540 million per year.

In addition, these concessional funds will be concentrated even more on the poorest and least developed countries in the hemisphere. During 1979-80, the initial years of this replenishment, at least 75 percent of convertible FSO resources would go to them. During the second half of the replenishment period, this minimum allocation would increase to 80 percent.

Because of their broad access to private capital markets, and their own recognition of the greater needs of their poorer neighbors, the largest and more prosperous Latin countries -- Argentina, Brazil and Mexico -- will restrict their capital borrowing to present levels. They will thereby reduce their percentage share of total IDB

capital lending although retaining sizable amounts in absolute terms. The Bank will help them adjust to this change by assisting in arranging an increased amount of cofinancing for their IDB projects, improving still further their access to private capital. As has been the case since 1975, Venezuela and Trinidad and Tobago will not borrow at all from the Bank during this replenishment period.

These constructive steps by the more advanced developing countries of Latin America will permit the middle level and poorer countries to attain substantial annual increases in their real rate of total borrowing from the Bank. This will in turn to help cushion their move from the concessional funds of the FSO to the harder lending terms of the capital window, and round out the three-step approach which recognizes the economic maturing of the region: (a) fewer borrowers from the concessional FSO's convertible currencies, (b) more capital lending for the countries shifting from the FSO to the capital window made possible by (c) increased reliance on private sector borrowing by the most advanced countries of the Hemisphere.

This replenishment also involves agreement to target IDB lending to poorer people in recipient countries. Those countries, outside the group of poorest and least developed,

who retain some access to FSO resources have agreed to limit their FSO borrowing wholly to those projects which directly benefit their poor people. As far as the Bank's total resources are concerned, it has been agreed that 50 percent of 1979-1982 lending will benefit low-income groups, primarily through the creation of productive employment opportunities in the rural and urban areas.

The IDB replenishment proposal before you also contains major advances in terms of burden-sharing by non-regional countries and advanced developing member countries.

The non-regional members of the Bank will contribute a share of the capital increase (11 percent) which is two and one half times larger than their current share of 4.4 percent. In addition, the non-regional members will contribute 30 percent of the FSO replenishment, the high level which they had agreed to as part of their entry into the IDB.

The subscriptions of the Latin American members (except Venezuela) to paid-in capital will be two-thirds in convertible currency -- an increase from the 50 percent previously subscribed in convertible currency by these members. As in the 1976-1978 replenishment, Venezuela will make its paid-in subscriptions entirely in convertible currency.

In continuation of the practice instituted during the 1976-78 replenishment, Venezuela and Trinidad and Tobago have again agreed to make all their contributions to the FSO in

convertible currency. Moreover, as an indication of their growing financial and economic strength, Argentina, Brazil and Mexico have agreed to increase the freely usable portion of their FSO contributions from 25 percent to 75 percent -- raising the level of resources fully by the FSO by $191 million.

As a result of these contributions and those of the non-regional countries, the U.S. share of convertible FSO resources has dropped from 57 percent in the last replenishment to 45 percent in the proposed replenishment.

As a result of these changes in the Bank's lending program and in the burden-sharing arrangements, this replenishment (in comparison to the previous replenishment) allows a reduction in the contribution paid in by the United States. To fulfill the proposed lending program of the IDB, the increase in capital resources for 1979-82 amounts to $7,969 million of which 7.5 percent or $598 million would be paid-in. The United States share of this increase would be $2,749 million -- 34.5 percent of the total -- comprising $2,543 million of callable capital and $206 million of paid-in capital. For the FSO, the increase proposed for 1979-82 would amount to $1,750 million of which the United States share would be 40 percent of the total or $700 million. The U.S. shares are those called for in the Sense of the Congress Resolution in the FY 1979 Foreign Assistance

Appropriations Act, and they have been accepted by the Bank's other members as appropriate levels of U.S. participation.

Also, under this replenishment only seven and one half percent of the capital will be paid-in, down from the typical 10 percent paid in during previous replenishments. Thus the annual U.S. subscription of $862.3 million involves $635.8 million of callable capital - which does not entail any budget outlay. The paid-in portion of the U.S. subscription would be $51.5 million annually.

The U.S. contribution to the FSO will decline absolutely from $200 million a year to $175 million a year. This is a twelve and one half percent reduction.

While the budget outlay commitments for the 1976-78 replenishment, as negotiated, were $240 million per year, the proposed 1979-82 replenishment would result in annual budget outlays of only $226.5 million -- an absolute reduction of $13.5 million. The reduction in real terms is, of course, much more substantial. For both capital and concessional funds, the budgetary outlays would as always be spread over a number of years because drawdowns are made only as needed to cover actual disbursements by the Bank or on the basis of an agreed schedule.

The Administration strongly recommends this replenishment proposal. The increase in the Bank's resources will provide funds to support projects which build on the major economic successes of the past decade in Latin America, and continue the development momentum which will lead one day to the establishment of dynamic economies able to finance their own continued development.

United States participation in the proposed increase in resources would constitute a positive and concrete expression of United States interest in, and concern for, the development of Latin America and the Caribbean. A continuing flow of resources through the IDB will help the region to further improve its economic situation and that of the millions of Latin Americans who still live in poverty. It is a cooperative effort in which the more advanced Latin American countries are joining the industrial countries in providing a part of the convertible currency resources for IDB lending to the poorest countries in the region.

ASIA

As recent weeks have shown, conflict and instability remain problems in Asia, and are of continuing concern to the United States. From the standpoint of security, a strategic balance now exists in the region.

It is clearly in our interest that this balance be maintained. Our policies are designed to preserve balance and stability in the region, prevent expansion of existing conflicts and maintain our commitments to our friends and allies. Our policies obviously do not entail a return to our earlier deep involvement in the internal affairs of the region.

We have concentrated instead on the development of long term sustainable policies that emphasize national self-reliance, supplemented by continued U.S. support. In this regard, we have been especially encouraged by the emergence of the Association of Southeast Asian Nations (ASEAN) which is a successful example of the regional economic cooperation we believe will contribute to stability in the area. We continue to place high priority on the region. We cannot afford to do otherwise.

Viewed in this light, U.S. participation in the Asian Development Bank offers an effective way to demonstrate continued U.S. concern in the area and its stability and to show our willingness to provide financial support for the economic aspirations of its people. Indeed, Asia contains the overwhelming majority of the world's poorest people. On the basis of strategic considerations alone, it is in our interest to support effective actions to improve the conditions of their lives and to promote greater stability in the area.

Thailand is one example of how the work of the Asian Development Bank can advance U.S. foreign policy objectives

in individual countries. Thailand has a central position in southeast Asia, and it has maintained a close relationship with the United States. It is in our national interest to support the stability and independence of Thailand because it is a key element of regional progress and balance in southeast Asia. We also have other important interests in Thailand. For example, Thailand's cooperation is essential if we are to have an effective narcotics suppression program. It has also provided a country of first refuge for Indo-Chinese refugees. Thailand is important as an expanding market for U.S. exports including cotton, tobacco, machinery, fertilizers, iron, and steel. It is also a reliable supplier of critical raw material imports such as tin, tungsten and rubber.

Economically, Thailand has grown at a rate matched by few developing countries. From 1960 to 1976, GNP growth averaged 7.6 percent a year. A high and rising level of investment has been maintained, exceeding 20 percent of GNP and largely financed by domestic savings. Per capita income doubled over the 1960-1976 period. Inflation has been kept under control by conservative fiscal policies, although price pressures have recently intensified.

In the past, economic policies have tended to favor Bangkok, other urban areas and the relatively better off farmers of the central plains. A large proportion of

the rural population, particularly in the northeast, has not shared equitably in the benefits of economic growth.

The present government in Thailand is beginning to reorient economic policy in favor of these elements of the rural population. The Prime Minister has declared 1979 the "Year of the Farmer" and has stated his government's intention to direct far greater resources to rural areas. The revised Five-Year Development Plan for 1977-1981 calls for external borrowing of about $1 billion per year to finance rural and infrastructure development to bring services and improved agricultural technology to the rural poor.

For 1979, the proposed borrowing program includes $324 million from the ADB. Under the proposed ADF replenishment, Thailand will become eligible for concessional financing of projects addressing the needs of its poor citizens. It is in our interest that the flow of financing continue to Thailand. Our participation in the Asian Development Bank and Fund will help assure that the country will be able to sustain its growth and carry out needed changes in its overall economic policies.

A second example is Pakistan. The turmoil in neighboring countries underscores U.S. interest in the security and stability of this Persian Gulf rim nation.

Pakistan suffers from political instability, a growing sense of isolation and recently economic stagnation. The most important contribution the United States can make to Pakistan's stability and long-term development is to assist in putting its economic house in order and, thereby, induce stability while political problems are resolved.

Pakistan is a poor agricultural country and its best prospects for growth lie in that sector of the economy. With one of the world's largest irrigation systems, Pakistan could become a major exporter of agricultural commodities while meeting the food requirements of its own population. It has a well-developed infrastructure in terms of railroads and roads, and there is sound industrial base upon which to expand. The ADF can, and is, helping Pakistan to develop this potential. Its assistance, totalling $290 million at the end of 1978, has been focused on the improvement of agriculture through the support of irrigation projects, the production of fertilizer inputs, of power for rural electrification, and cement for use in civil works in agriculture.

THE ASIAN DEVELOPMENT FUND

Recently, there has been a significant increase in cooperation among the nations of Asia. This is exemplified by the efforts of the ASEAN to work together among themselves and with the rest of Asia and the industrialized world in an effort to increase regional regional stability and prosperity. The Asian

Development Bank and Fund, as visible, technically qualified, moderate and respected regional institutions both aid and are aided by this move to increased regional self-reliance. Our participation in the Bank and Fund constitutes a clear, demonstrable statement of our interest in the region and associate the United States with the region's goals and aspirations.

The Asian Development Fund (ADF) was established in 1974 to mobilize concessional resources, on an organized and regular basis, to consolidate and standardize the Asian Development Bank's lending to the smaller and poorer developing member countries in Asia.

Six member countries account for the major share of these concessional loans: Pakistan, Burma, Nepal, Afghanistan, Bangladesh and Sri Lanka. These six are among the poorest countries in the world, and several of them are of central importance to U.S. foreign policy. Several Pacific islands which are of importance to U.S. policy toward the region (particularly the Solomons and Western Samoa) receive ADF funds -- our primary channel for providing assistance to them. In addition, under the proposed replenishment, the Fund will resume modest amounts of lending for basic human needs projects in Indonesia, the Philippines and Thailand. India has voluntarily refrained from receiving funds from the ADF, relying instead on IDA as its principal source of concessional aid.

Our goal in the replenishment negotiations was to ensure that substantial resources were provided for the ADF's activities, and that these resources should be more sharply focused on the poor. We were able to achieve an agreement that agricultural investment and rural development programs would continue to be the primary lending sectors of the ADF, and that these projects would increasingly focus on benefitting the poorer segments of the population. We also achieved a resumption of lending to "marginally eligible" countries -- Thailand, the Philippines and Indonesia -- for projects which meet basic human needs.

The U.S. share of the total replenishment of $2.15 billion for the 1979-1982 period amounts to $445 million. This represents a substantial degree of burden-sharing. This is 20.69 percent of the total, below the level suggested by the Congress (22.24 percent) in the FY 79 Foreign Assistance Appropriations Act and consistent with the Sense of the Congress provision in Public Law 95-118. This share will require annual appropriations for the 1979-1982 period of $111 million. Authorization of the proposed U.S. contribution is required in 1979, and appropriation of the first tranche in FY 80 to prevent ADF commitments ceasing in December 1979.

AFRICA

We are proposing an increase in U. S. contributions to the African Development Fund. The African continent has assumed a much greater foreign policy importance for the United States which stems from the following factors:

-- Africa is a growing locus of power both politically and economically.

-- It commands vital economic resources which are essential to the United States and the industrialized nations of the West.

-- It occupies a strategically important geographic position.

-- It continues to experience instability and political and military weakness which could draw in larger, non-African powers for the resolution of local wars and pose risks for elevating and broadening regional conflicts.

-- It has acute problems of poverty and economic underdevelopment which have the potential to cause growing resentment against the United States and other developed countries.

In addition, African countries now play a prominent role in international politics and in the conduct of world diplomacy. By themselves, they comprise almost one-third of the membership of the United Nations. Together with

other developing countries, they account for two-thirds of the membership of that organization. We need the cooperation of African countries to resolve the kinds of international problems which I have already mentioned.

At the same time, Africa continues to have problems of instability and violence. Insurrection and rebellion have occurred in certain countries. These conflicts have been caused by a number of factors including ethnic unrest, secessionist ambitions, and religious differences. They all provide opportunities for non-African intervention and exploitation. Further, the persistence of racial injustice in southern Africa threatens the stability of the area.

In terms of the individual countries, Nigeria is the largest U.S. trading partner on the continent. Annual U.S. exports to that country currently exceed $1 billion, and Nigeria supplies us with almost 20 percent of our petroleum imports. After Saudi Arabia, it is our second largest source of foreign crude oil. Nigeria has taken a constructive leadership role and consistently opposed outside intervention in African conflicts.

In both economic and humanitarian terms, Africa represents the world's greatest development challenge. It is the least developed continent, containing two-thirds of the world's 30 poorest nations and some of the world's most deprived and disadvantaged people. More than a third of its nations have a per capita income of $200 or less. In most countries of the region the numbers of individuals living in absolute poverty amount to more than one-third of the population. Seventy five percent of Africa's population is engaged in subsistence agriculture. Life expectancies in Africa average 43 years -- 10 years less than those in other developing countries and 30 years less than those in the United States. Less than 20 percent of the population of sub-Saharan Africa has access to safe drinking water.

Growth rates in Sub-Saharan Africa remain well below those in other developing regions. Per capita incomes expanded at a rate of less than 2 percent per annum in 1960-75. Although a large percentage of African labor works in the agriculture sector, agricultural production has also grown slowly, increasing at an annual rate of about 1.5 percent since 1960. This rate of growth has not been sufficient to keep up with the increase in population.

THE AFRICAN DEVELOPMENT FUND

The African Development Fund (AFDF) represents an important means to help these countries break out of the vicious cycle of poverty. It was created in 1973 as the concessional lending affiliate of the African Development Bank (AFDB). The Bank itself was established in 1964 to make loans to African nations on near-market terms; it has no non-African members.

The Fund makes concessional loans to the poorest countries in Africa. Except under the most unusual circumstances, loans are not granted to countries with 1976 per capita GNP above $550. Absolute priority is given to nations with per capita GNP below $280. The African Development Fund has concentrated its efforts on those most in need: in 1977, 64 percent of its lending went to countries with a per capita income of less than $280. In that same year, loans targeted to assisting the poor accounted for approximately 60 percent of total lending.

In the replenishment negotiations, it was agreed that the Fund's efforts to reach the poor should be continued and intensified. During 1979-1981, 80 percent of the Fund's resources will be lent to the poorest countries -- with a per capita GNP below $280. With respect to sectors, it was agreed the AFDF would focus particular

attention on projects aimed at meeting basic food and health requirements and at increasing the effective utilization of human resources through training in such areas as agriculture. The AFDF is reaching those whom the United States believes should receive top priority for development assistance.

The AFDF donors agreed to a second replenishment which will permit the African Development Fund to expand its efforts to aid Africa's poor in the 1979-1981 period. The U.S. contribution of $125 million to the second replenishment would be 17.5 percent of the total of $713.5 million of pledged resources. This U.S. share represents an increase in our position in the Fund. Recently, our share of Fund resources has been under 6 percent -- which was equal to Norway. We believe that a much more substantial U.S. share in this institution is consistent with both our objectives of increased burdensharing and the high priority placed on strengthening U.S. relations with the countries of Africa. The resulting 17.5 percent is still substantially less than our share in any of the other MDB windows. It is consistent with the Sense of the Congress Resolution, and we believe it is essential to demonstrate our interest in assisting growth and development in Africa.

We believe that the African Development Fund is an increasingly effective regional institution which can help to address the enormous problems of poverty and

underdevelopment which exist on that continent. It is the kind of cooperative organization that we want to encourage because it provides us with a practical way to assist African development without unwarranted and direct involvement in the affairs of individual countries.

I would like to mention briefly the opening of membership in the African Development Bank (AFDB) to non-regional members. This Bank is unique among the MDBs in that its membership has been drawn entirely from regional developing nations since its establishment in 1964. It has no members from the ranks of the industrial countries. As a result, its subscribed capital after 15-years is currently only $957 million and its cumulative loans total $620 million. In order to strengthen the Bank's resource base and lending program, negotiations have now been undertaken, pursuant to a 1978 authorization by the African Governors, to begin the participation of non-regional members in the Bank.

The Administration strongly supports the efforts of the African Development Bank to expand its base of resources. We have participated constructively in discussions with other non-African countries considering membership, and are now envisaging a U.S. capital subscription on the order of $360 to $400 million (to be contributed over a five year period FY 81-85) which would also represent a U.S. share

of about 17-18 percent. This would provide us with our own Executive Director at the Bank, and make us the largest single shareholder in it. We will be consulting with you on details of U.S. participation in the Bank, looking toward the submission of legislation on it next year.

Africa's critical importance to the management of international political and economic affairs is now well-established. Our proposed support for this replenishment of the African Development Fund as well as our prospective entry into the African Development Bank itself, reflect the strong commitment which the Administration and Congress share in supporting the aspirations of African peoples for a better life.

CONCLUSION

The Administration strongly supports the proposed replenishments I have presented to you today. The unfinished business of development represents a serious challenge to the economic and political stability which we and other nations require if growth and prosperity are to be sustained.

In my remarks today, I have emphasized the important foreign policy interests that we have in the developing activities of the world. We will have more success in asking these countries to share our

goals for a better and safer world if we are willing to help them achieve their goals of better and safer lives for their own people. Our participation in the MDBs and the overall levels of our foreign assistance are judged as a signal of the seriousness of our response to their problems. This basic reciprocity lies at the heart of U.S. relations with the developing countries.

The multilateral development banks provide a practical and effective way for us to collaborate with developing countries and to help them meet their most basic aspirations. They are also a forum for cooperation with industrialized countries. I mentioned earlier the increased role which these countries are playing in the banks, by shouldering larger shares of the costs of their activities. We participate with these countries in discussions within the banks on all issues of development policy and alternative approaches to the use of development assistance funds. We have recognized for many years that cooperation with other industrial countries is key to the well-being of the United States. Our collaboration with them on these

development questions positively affects our overall relationships with these countries and our dealings with them in other fora.

For all of these reasons, we strongly support continued U.S. participation in the multilateral development banks. The proposals which are before you today deal only with the regional banks, which play a special role in the international economic system. Their operations reflect the assessments made by regional members of their own needs and they have an expertise and understanding of local conditions and problems. The regional development banks serve as useful complements to the global programs of the World Bank Group. Most importantly, U.S. support for these Banks manifests our interest in the development and progress of the respective regions and thus has particular political as well as economic significance.

Department of the TREASURY NEWS

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STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON REVENUE SHARING,
INTERGOVERNMENTAL REVENUE IMPACT, AND ECONOMIC PROBLEMS
SENATE FINANCE COMMITTEE

Mr. Chairman and Members of this distinguished Subcommittee:

I appear before you today to discuss the Intergovernmental Fiscal Assistance Amendments of 1979, which the President submitted to Congress last week. Through 1980, this two-tiered legislation would provide targeted fiscal assistance to fiscally distressed local governments and a stand-by fiscal assistance program for State and local governments.

Concerning the first tier, we recommend targeted fiscal assistance expenditures of $250 million in 1979 and $150 million in 1980. This compares to $1.3 billion spent last year under a similar, predecessor program. We do not project any outlays under the program's stand-by tier. It would only operate if national quarterly unemployment reached 6.5 percent in 1979 or 1980, and the Administration forecasts a maximum rate of 6.2 percent over that period.

My testimony will cover three major areas:

-- A brief review of the history of this legislation.

-- Targeted fiscal assistance--why a need exists for further assistance on a limited basis, and how we propose to provide it.

-- Stand-by Fiscal Assistance--the importance of having such a program in place and the details of our proposal.

A Brief History

Three years ago, during the deepest U.S. recession since the 1930's, many urban and rural communities were experiencing severe fiscal distress. The recession had weakened their revenue bases at the same time that their unemployment and service costs rose sharply. Many localities began to experience widening budget deficits and some were threatened with insolvency.

In 1976, Congress enacted the Antirecession Fiscal Assistance (ARFA) program--frequently called countercyclical revenue sharing--to provide emergency fiscal assistance to these distressed States and local governments. President Carter then proposed in 1977 that this program be extended, and Congress agreed.

Over a nine-quarter period, therefore, approximately $3 billion of such antirecession funds was distributed to an average of approximately 18,000 recipient governments. We think these expenditures were effective in avoiding excessive layoffs of essential workers, reductions in vital services and counterproductive tax increases.

Essentially, the ARFA program distributed $125 million per quarter when the national unemployment rate (seasonally adjusted) reached 6 percent for a calendar quarter. It also allocated an additional $30 million for each one-tenth of one percent in excess of this 6 percent level. Eligible States received one-third of total disbursements and eligible local governments received two-thirds. A government became eligible if its own unemployment rate was 4.5 percent or more, and the individual allocations basically were determined by the excess of a recipient's unemployment over this 4.5 percent base level.

The ARFA program targeted its funds effectively to those State and local governments which needed them most. In 1978, two-thirds of the total disbursements were distributed to recipients whose unemployment rates were 8 percent or more.

The ARFA program was reauthorized only through 1978 and, in May of last year, the Administration proposed a similar, successor program to operate through 1980. After careful study, we had determined that a series of local governments continued to experience severe fiscal distress. Indeed, we provided a formal study to Congress on this subject.

Last Fall, the Senate Finance Committee reported out a bill, which we supported and the full Senate passed, which would have continued Federal fiscal assistance to these governments. Unfortunately, this legislation failed in the House

on the final day of the 95th Congress. ARFA funds were thus cut off to all recipients on September 30 of last year.

Need For Targeted Fiscal Assistance Program

The Administration's judgment is that these funds--$1.3 billion last year--should have been phased out gradually, not terminated in one step. Accordingly, we have proposed the much reduced outlay levels of $250 million in 1979 and $150 million in 1980. This phase-down would be consistent with the fiscal recovery of many localities and the related pattern of annual reductions in ARFA funding since the 1976 peak of the State and local fiscal crisis.

There is a need for continuation of fiscal assistance, however, because certain urban and rural localities around the country remain fiscally strained and need more time to recover. They cannot eliminate their dependence on antireces-sion funds without experiencing severe budget dislocations and related layoffs, service cutbacks and tax increases.

Let me illustrate the importance of the previous ARFA program to certain particularly strained areas. In 1978, Treasury published a Report on the Fiscal Impact of the (Carter) Economic Stimulus Package on 48 Large Urban Governments. It concluded that a number of these governments were in a serious state of fiscal distress. Our latest statistics indicate some improvement but the underlying problem continues in certain areas.

Their local tax rates are at legal or economic limits, and tax revenues thus cannot be increased meaningfully in the immediate future. Despite efforts to cut their budgets, these governments are experiencing inflationary pressures which are driving local expenditures higher. Additional research has demonstrated that this same combination of stagnant revenues and inflation-driven expenditures is also afflicting many rural governments.

Treasury's study also showed that the more seriously strained local governments received a proportionately greater share of ARFA payments and that such governments could not easily offset the loss of such payments. For example, last year, the ten most severely strained of our largest municipalities were receiving ARFA funds representing between approximately 2 percent and 7.5 percent of their so-called "own-source" revenues. Theoretically, these governments could raise taxes or cut expenses to replace them. Unfortunately, neither of these alternatives is readily available to distressed local governments. This is why the Administration is recommending a phasedown of fiscal assistance over the next two years.

A second basic illustration of the need for targeted fiscal assistance involves the combined effects of underlying fiscal distress plus last year's funding cut-off on a series of particularly hard-hit areas. Examples include the following:

-- Detroit budgeted $19 million of anticipated 1979 ARFA receipts and the program's termination was a major contributing factor in the layoff of 350 employees and other budget reductions.

-- St. Louis anticipated $6.5 million in 1979 ARFA funds and now must close a budget deficit of approximately half that amount.

-- New Orleans had to enact three new revenue measures which equalled approximately 15 percent of its 1979 budget.

-- After having already reduced its work force by 1,300 employees, primarily through lay-offs, Philadelphia had to cut another $14 million from its 1979 budget due to that amount of shortfall in anticipated 1979 ARFA receipts.

-- Newark laid off 450 employees in the immediate wake of the program's termination, including 200 police officers.

-- El Paso reduced its workforce by five percent.

-- Pittsburgh was forced to increase both its city income tax and its property tax.

-- Hidalgo County, Texas had to reduce its already small workforce by layoffs and attrition.

How The Targeted Fiscal Assistance Program Would Work

Let me turn now to a brief discussion of the program's major features.

This program would authorize the expenditure of $400 million as follows:

-- $250 million in FY 1979 for approximately 1231 local governments with unemployment rates of 6.5 percent or more for the six-month period of April through September, 1978,

-- $150 million in FY 1980 for somewhat fewer governments based on the unemployment rates for the first 6 months of 1979.

The share of each local government would be determined by its excess unemployment above 4.5 percent multiplied by its general revenue sharing allocation--this is the previous (ARFA) approach. Payments would be made annually, and as soon as possible in the case of the 1979 allocations. One-half of one percent of the total funds requested would be distributed on a population basis to the Commonwealth of Puerto Rico, Guam, American Samoa, and the Virgin Islands.

Distributional Effects

By any reasonable measure, the program's funds will be highly targeted according to need. Only 1,231 local governments would receive funds in 1979, based on the most recent unemployment data. This compares to the 39,000 recipients of General Revenue Sharing funds and the 17,000 average recipients of 1978 ARFA funds.

In addition, 70 percent of 1979 funds will be distributed to localities currently experiencing unemployment rates of 8 percent or more. The 10 "highest strain" cities would receive 34 percent of the total 1979 funds.

Small communities also get a fair share of program funds. Approximately 45 percent of the eligible areas have populations below 25,000 people. In addition, half of the eligibles are counties, not cities.

Role of the States

State governments are not eligible for targeted fiscal assistance, although they would fully participate in the standby fiscal assistance program. Studies indicate that, as a group, State governments are not fiscally strained today. Indeed, fifteen States provided for personal income tax relief in 1978, through either reduced rates or exemptions, credits, or deductions. Major State revenue sources--sales and income taxes--have been more responsive to improvements in the national economy than the principal local revenue source--property taxes. Accordingly, as the economy has improved over the past 50 months, State revenues have increased at a faster rate than local revenues.

Use of Unemployment Rates

Concerning eligibility, we have selected local unemployment rates as the proxy for fiscal distress. We have found the unemployment-based antirecession formula to be effective in targeting funds to places with serious economic and fiscal problems. For example, the ten "highest fiscal strain" cities receive substantially higher per capita allocations than less strained cities.

We selected average unemployment rates of 6.5 percent or more for determination of local eligibility. Unemployment over the past year has hovered around 6 percent and a rate of one-half percent above this level produces considerable targeting.

Administrative Issues

Our legislation includes two important provisions relating to administration of the Targeted Fiscal Assistance program. The first involves a per capita income limitation such that eligible recipients must have per capita incomes of less than 150 percent of the national average. This requirement avoids rewarding particular places where, despite high unemployment, considerable taxable wealth may be found.

Second, we have included a $20,000 minimum annual payment test for eligibility. This "de minimis" test means that when a recipient's potential allocation falls below that amount, either in FY 1979 or in FY 1980, that locality is not eligible and the funds are redistributed among those whose allocation is above $20,000.

The expired ARFA program provided that a government could receive as little as $100 per quarter. We find that minimum payment simply too low. The minimum should be large enough to sustain one or perhaps two jobs.

Stand-by Fiscal Assistance Program

Let me turn to the second-tier of this legislation--the stand-by fiscal assistance program for State and local governments. This program is similar to the 1976-1978 ARFA program except that it would only operate when the national quarterly unemployment rate reaches 6.5 percent or more, instead of 6 percent, and the eligibility requirement for recipients would be raised from 4.5 percent unemployment to 5 percent.

The current Administration economic forecast does not anticipate that national unemployment rates will reach 6.5 percent or more through 1980. Thus, we do not project any budgetary outlays under this stand-by portion of the program.

Should an economic downturn occur in 1980, however, we want State and local governments to have the assurance of Federal assistance to help them avoid precipitous layoffs, service curtailment, sudden reductions in procurement and capital outlays, or tax increases. We also think it important to avoid past mistakes of having a countercyclical program that triggered on too late in the recession and triggered off too late into the recovery.

How the Stand-by Program Would Work

Our proposal builds on what we have used in the past. It is intended to be relatively simple and easily understood. For example, the allocation approach of unemployment data combined with the general revenue sharing formula is widely understood. This approach--using unemployment, tax effort, population, and income data--reflects a legislative consensus on fairness. In addition, this approach has broad support because it is simple and inexpensive from an administrative viewpoint.

The program would operate only if quarterly national unemployment rises to 6.5 percent or higher in 1979 or 1980. At that point, it would distribute $125 million per quarter plus an additional $25 million for each one-tenth of one percent by which national unemployment exceeds 6.5 percent. Individual State and local governments with quarterly unemployment rates of 5 percent or more would be eligible. Approximately one-third of the funds would be distributed to State governments and two-thirds to local governments.

The maximum amount of funds to be distributed under this stand-by program, should it operate, would not exceed an annual allocation of $1 billion and no funds are to be paid after September 30, 1980. This means that the last calendar quarter for which national unemployment data will affect payments would be the quarter ending March 31, 1980.

We have included a payment adjustment provision linking the first tier of the bill to this stand-by tier. To avoid windfall funding, if the stand-by tier is triggered, allocations to local governments in any fiscal year under this second tier would be reduced by the amount of payments they would receive under the first tier in that year.

The stand-by program includes the same per capita income test and equivalent minimum quarterly payment tests, as in the Targeted Fiscal Assistance tier.

Conclusion

The Intergovernmental Fiscal Assistance Amendments of 1979 constitute an important aspect of the President's domestic program. It is a balanced two-tiered program that addresses the immediate needs of a limited number of fiscally strained local communities as well as the prospective needs of State and local governments as they face economic uncertainty. A minimum amount of expenditure can have considerable impact without jeopardizing the budgetary and fiscal goals of this

Administration. A stand-by program offers the prospect of providing a sensible fiscal insurance program for State and local governments in the event of future excessive unemployment.

We have purposely designed this program to bridge the time remaining until the expiration of General Revenue Sharing in 1980. The expenditure of $400 million in FY 1979 and 1980 phases down the amount of funds received by the most fiscally distressed communities while stand-by fiscal assistance assures a timely response to economic downturn. The proposed legislation will expire on September 30, 1980, together with GRS. This will facilitate a 1980 Executive Branch and Congressional review of the entire issue of Federal fiscal assistance to State and local governments.

I appreciate the opportunity to present the Administration's program for fiscal assistance. I look forward to working with you and other members of Congress toward implementing the program.

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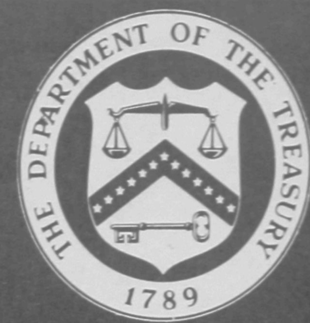

<u>FOR RELEASE UPON DELIVERY</u>
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STATEMENT OF DONALD C. LUBICK
ASSISTANT SECRETARY FOR TAX POLICY
DEPARTMENT OF THE TREASURY
BEFORE THE COMMERCE, CONSUMER AND
MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS
WASHINGTON, D.C. [March 14, 1978]

Mr. Chairman and Members of this distinguished Subcommittee:

I welcome this opportunity to appear before you to report to you how Treasury and the Department of Energy interact to formulate the tax aspects of national energy policy and the extent to which the Department of Energy participates in the promulgation of tax regulations and rulings which implement energy-related tax provisions. This subject is of great concern to the Treasury Department. It touches upon issues that are basic to our tax system, such as the fairness of tax burdens, as well as the manner by which we go about financing Federal expenditure programs.

In order to examine the issues before the Committee, let me begin by discussing two sets of distinctions which are basic to the involvement of Federal agencies in tax policy.

(1) First, we must separate those provisions of the tax law which are a part of the structure through which revenues are raised, from those provisions which

modify that structure as a means of implementing Federal intervention in particular markets. For example, the investment tax credit represents the payment of a Federal grant through the tax system as do provisions permitting financing through tax exempt bonds. Other intervention devices include rapid amortization and expensing of capital expenditures. The latter are income measurement rules which deviate from normal tax accounting rules.

(2) Second, we must distinguish formulation of tax policy through the legislative process (what the law ought to be) and the administrative implementation of tax legislation through regulations and rulings (how existing law is to be interpreted).

(1) Distinction Between Tax Structures and Tax Subsidies.

Agencies with substantive outlay programs, as opposed to agencies having fiscal and monetary policy responsibilities, such as Treasury, the Council of Economic Advisors and the Office of Management and Budget, should not be expected to have significant involvement in the promulgation of general tax policy; that is, in issues involving the appropriate level of aggregate tax revenues; the rates of personal and corporate taxes, the taxation of capital gains, the degree of progressivity of the tax system, the manner of taxing foreign source income, and other matters affecting the basic structure of the tax system. These issues involve policy considerations that transcend effects on particular sectors of the economy.

In developing or responding to general tax proposals, as, for example, the proposals relating to the levels of the taxation of capital gains, the Treasury Department must examine such factors as the effect on revenues, the fairness of tax burden distribution, the short-run impact on aggregate demand, the long-run impact on the rate of economic growth, the effect on allocation of economic resources, and the ease of taxpayer compliance and IRS administration. Treasury does consider the special concerns of other government agencies (including DOE) and private organizations as it explores these basic tax policy issues. But the weight to be accorded industry-specific effects of general tax proposals is necessarily limited; the potential impact on a particular industry is only one factor that must be weighed in the balance.

In contrast to this set of general tax policy issues are modifications of the tax system which constitute specific interventions in an industry or market. Such interventions include the imposition of excises to adjust market prices as well as the use of tax preferences to subsidize specific economic activities. An obvious example is the Energy Tax Act of 1978. With respect to this set of focused tax matters, agencies with substantive program responsibilities have an obvious and important obligation of involvement.

It is important to bear in mind, however, that the objectives of programatic tax measures are indistinguishable from objectives which might be achieved by regulatory or expenditure programs that can be administered by the agency having substantive responsibilities in the subject area. Tax programs represent one of many choices available to the Federal government for financing desirable conduct. Among the more obvious alternatives are cash grant and loan programs. Thus, the agency having substantive responsiblity for a program bears a double burden. It must first establish that <u>any</u> Federal program is needed.

Should the money be spent? What will the program accomplish? What are the specific details of the program? Who gets the government money and why? Is the program open-ended or does it have a cap? What assurances are there that the money will be spent for the proper purpose?

These are questions which must be faced as squarely when a tax expenditure proposal is under consideration as when a direct expenditure program is being studied. Tax subsidies invoke spending money in the same way as direct expenditures and have the same deficit effect as direct expenditures. The tax system represents only a means of delivering a Federal subsidy. Yet, frequently agencies and the Congress don't submit tax proposals to the same degree of scrutiny as they insist is required for direct expenditure programs.

If an agency is able to justify a Federal expenditure and has worked out the details of the program, it should next provide persuasive reasons why the administration of the program requires the use of the tax system and why nontax options have been rejected. In doing so the agency must recognize that one of the consequences of using the tax system to intervene in private markets is the relinquishment of administrative control by the agency with normal responsibility in the substantive area. This consideration is

insufficiently weighed by many executive agencies eager to promote programs executed through tax excises or subsidies. While agencies are grateful to be relieved of budgetary and administrative responsibilities, they may be discomfited by the concomitant loss of administrative control.

There are also the following considerations at stake here:

-- Creating new tax initiatives--whether deductions, credits or tax-exempt financing-- is an increasingly popular way to spend federal money without appearing to create new "programs" that spend money and without incurring the discipline of annual appropriations and associated executive and Congressional budgetary scrutiny. Normally, once a tax subsidy is in the Code it is all but impossible to repeal or terminate it, even though the justification for its initial inclusion is no longer compelling.

-- Tax subsidies are almost invariably a less cost-efficient way to attack the problems they were created to solve than is programmatic spending.

-- Tax subsidies invariably generate great complexities in tax filings and administration.

-- Tax subsidies impose substantial burdens upon the Treasury and the IRS whose employees are diverted from their primary goal of tax administration. For example, during the planning and legislative phases of the Energy Act members of the Tax Policy Staff at Treasury were required to become energy experts. Now that the Act is effective this burden has been shifted to the IRS which must become an energy administrator in addition to dealing with other special programs which are carried out as tax expenditures. This process is wasteful because expertise in energy matter already exists in DOE and is costly because the expertise, once developed in both agencies, is duplicated.

-- Another troublesome aspect of the use of tax subsidies in lieu of direct expenditures is that almost without exception they are offered in tax exempt form. Since the value of a tax subsidy to the recipient is the amount of tax foregone, the same nominal amount of subsidy produces greater benefits at higher marginal tax

brackets. As a result, the magnitude of tax subsidy programs is understated since analysts tend to look at budget impact (tax revenues foregone) rather than the amount which a taxpayer would otherwise be required to finance on his own in pre-tax dollars.

-- Tax subsidies are useful only to those who have income taxes to pay and hence can benefit from the subsidies. Those who don't pay taxes--individuals below exemption and zero bracket amount levels or otherwise insufficient tax liabilities; corporations with no net earnings (perhaps because they are just starting up); non-profit organizations, states and local governments--receive no assistance. In order to reach these groups a tax subsidy program must be supplemented by a direct grant program. This in fact was was done in the Energy Act. The regulatory weatherization program provides conservation assistance for low-income individuals and certain tax exempt organizations while the residential tax credit assists individuals who are taxpayers. If a tax subsidy is to cover these excluded groups it must be "refundable". A refundable tax credit is virtually indistinguishable from a direct spending program. The question then to ask is why use a bifurcated program--tax credit plus direct spending--rather than a single direct spending program.

-- One reason often given in support of tax subsidies is that when the tax system is used bureaucrats and red tape are not involved. However, an IRS agent is a bureaucrat and the Tax Code and the regulations which interpret it have their own share of red tape. What this means, of course, is that which bureaucrat should administer the program and how much red tape must be present are matters of program design. Ideally, the bureaucrat should be the one having substantive knowledge of the subsidized market and the "red tape" should be designed to assure efficiency of the program.

If an agency is able to demonstrate that non-tax subsidies would be ineffective and specific tax subsidies are justified, close cooperation between Treasury and that agency is critical. In the case of energy tax incentives, for example, consultation between the Treasury and the Department of Energy should begin in the initial stages of energy tax policy development and must continue until a final policy decision is made. DOE has the data resources and expertise

by which to gauge the impact of a tax subsidy proposal on energy policy. Treasury has the information for assessing impact of that proposal on the progressivity of rates, the possibility for unintended tax sheltering effects, problems of taxpayer compliance and IRS administration, interaction with other tax provisions, and efficiency of the program.

(2) <u>Distinction Between Formulation of Tax Policy Through Legislation and Administrative Implementation of that Policy Through Regulations and Rulings</u>.

The Internal Revenue Code imposes on the Secretary of the Treasury (or his delegate) the legal responsibility to write regulations implementing the provisions of the Code, to issue rulings that interpret the application of the tax laws to particular circumstances, to prescribe procedures by which taxpayers may discharge their obligations under the tax laws, to enforce the tax laws, and so on. Treasury, and more particularly, the IRS, cannot share this responsibility. The reason for this is obvious. Public confidence in the administration of the tax laws can only be maintained if the public perceives that tax obligations are imposed and tax benefits are dispensed even-handedly and in accordance with Congressional mandate and not in accordance with determinations by the Treasury or IRS of what is "good" conduct to be rewarded and "bad" conduct to be penalized.

We have noted the obligation of executive agencies to participate in the development of tax legislation proposals specific to their regularly assigned program responsibilities. Limited participation in the promulgation of regulations to interpret such tax legislation is also commonly sought by the Treasury. In any event, proposed regulations are generally published for public comment, and hearings scheduled to elicit views from all interested parties. Although ultimate responsibility for promulgating regulations must rest with Treasury, we take these comments into account in issuing the final regulations.

After the statute has been enacted and regulations published, application of the law to particular taxpayers is a matter to be resolved between the IRS and those taxpayers. At that point, all tax provisions, regardless of the reasons for their inclusion in the Code, are indistinguishable. It is improper for other agencies to intervene with comments about substantive policy or political implications of IRS administration of the tax laws insofar as individual taxpayers are concerned.

Having explained generally how the tax laws and their administration interact with the programs of other agencies, let me turn to our particular experience in the energy area. The Treasury Department and the Department of Energy have consulted concerning the energy tax proposals which formed the basis for the Energy Tax Act of 1978 and continued to do so during the two-year period in which the legislation was pending in the Congress. We continue to consult with DOE regarding new tax initiatives which are under study by that agency. As to all those new initiatives we have requested that DOE consider non-tax options as a means of accomplishing the same objectives.

Insofar as the promulgation of tax regulations implementing the Energy Tax Act are concerned, we have consulted with DOE in the course of drafting of the regulations, regarding a wide range of issues. DOE's comments have been solicited as the regulations have been developed, and this consultation will continue up until the time when the regulations are finalized. We also anticipate receiving DOE's advice on technical matters such as performance and quality standards of energy equipment as the need for such advice arises. However, ultimately responsiblity in promulgating the regulations rests with the Treasury Department.

As I noted earlier, after the statute has been enacted and regulations published, the Department of Energy will have a minimal role to play in further administration of the tax law. For example, the residential credit provisions of the Act authorize the Secretary of the Treasury, at his discretion, to add additional items to the list of items eligible for the credit. We anticipate that DOE will be consulted in this regard. However, as I noted earlier, this loss of administrative control is one of the consequences of implementing a subsidy program through the tax system.

Internal Revenue Service rulings concerning eligibilty of taxpayers for energy credits will be issued without DOE participation. These rulings involve the application of the whole body of tax law to taxpayers having certain property rights and contractual arrangements. If IRS administration is to be even handed, it cannot base its rulings on considerations of current energy policy or, for that matter, housing policy, trade policy, environmental policy, and so on. Once measures are incorporated in the tax laws, their application and interpretation are constrained by the legal and traditional institutions of tax administration. These constraints

are necessary in order to assure that there are no charges of partiality, favoritism or undue influence in the administration of the tax laws.

In order to formulate and implement energy tax policy, the Treasury Department Tax Policy Office has assigned two lawyers and two economists to the task of analyzing energy tax matters. The lawyers, in addition, provide policy guidance to IRS staff having the responsibility for drafting regulations, printing forms and giving guidance to the public. The IRS staff have DOE contacts in various areas of expertise and consultations, both formal and informal, take place concerning various problems as they arise. Similarly, DOE staff contact Treasury with respect to questions or problems which need to be resolved.

(3) The Foreign Tax Credit

The Committee has also asked that I focus on the foreign tax credit as an example of where energy policy and tax policy may intersect. You have also inquired about the standards used in making payments creditable by way of a tax treaty.

I will begin my response with a brief explanation of the foreign tax credit. The United States taxes the worldwide income of U.S. persons, and, because of that, grants a foreign tax credit for foreign income taxes and taxes paid "in lieu of" income taxes. The foreign tax credit applies not just to oil companies but to all U. S. taxpayers, whatever the nature of the business, wherever they earn foreign source income.

The purpose of the credit is to avoid double taxation of income. The credit is not an incentive for an industry to earn foreign income, much less to relocate overseas. It is an attempt to make tax law neutral in the choice of domestic and foreign investment. The foreign tax credit simply recognizes that while the United States always maintains the right to tax the foreign-source income of U.S. persons, the country where income arises has the right to the initial tax on that income. U.S. persons earning such income might be subject to excessive income taxation if the U.S. tax burden were added to whatever burden exists in the source country. Such a double income tax would place U.S. persons at a competitive disadvantage. Thus, the foreign income tax burden is allowed to offset U.S. tax liability.

Aside from special statutory limitations on the amount of foreign oil related taxes that can be used as a credit in the U.S., the foreign tax credit rules and principles applicable to the oil industry are the same as those applied to all other industries and taxpayers. The Code draws no distinctions among lines of business for determining what qualifies as a creditable income tax. The Code does not provide that energy policy or other non-tax policy considerations such as foreign policy should play a role in deciding whether an oil payment is creditable.

The case where the foreign tax credit may operate as an incentive in the oil and gas area is where a taxpayer erroneously obtains a credit for a cost of goods sold such as a royalty or excise tax by having the payment disguised as an "income tax." In such a case a de facto preference exists for the foreign operation as compared to U.S. oil operations. The IRS and Treasury have expended considerable effort to assure that royalties and excise taxes are not being claimed as creditable income taxes. We are in the process of developing regulations that we expect will cover, among other issues, both the royalty-tax and the excise tax issues. Also, the IRS, in 1978, revoked two rulings that relate to this question: Rev. Rul. 55-296 involving Saudi Arabia and Rev. Rul. 68-552 involving Libya. Neither the substance of these rulings nor the Indonesian rulings which this Committee refers to (Rev. Rul. 76-215 and Rev. Rul. 78-222) were based on any energy policy considerations.

It must be remembered that under U.S. tax law as it stands today every foreign country is entitled to impose a creditable income tax. The principal question in the oil and gas area is whether the country decides to levy a tax and levies it in a manner that meets U.S. standards of an income tax or whether it, as owner of a mineral, decides to take a share of revenues by way of profit-sharing royalty or excise tax. In answering this question the IRS looks to both the form and the substance of the payment.

In summary, the foreign tax credit is a broadly applicable and important element of U.S. tax policy. Consistent with a general policy of equity and fairness the same principles apply to all taxpayers in determining whether their payments qualify for the foreign tax credit. Energy policy is not a factor that is taken into account.

You have inquired about the use of tax treaties to provide companies with foreign oil tax credits that would not be otherwise allowable.

The overall purpose of a tax treaty is to avoid double taxation of income. Measures are generally taken to assure that double taxation does not occur and that it is mitigated when it does occur. A tax treaty defines areas where either the source country or the residence country will have the right to tax income. Where both countries retain the right to tax, double taxation is avoided in the U.S. by means of a credit of the foreign tax against U.S. tax. As a general rule U.S. tax treaties contain provisions designed to guarantee the creditability of the foreign taxes covered by the treaty. Frequently, these provisions operate independently of the statutory rules.

A further consideration in crediting foreign taxes by treaty is that a tax treaty is a forum in which to resolve issues and disputes between the taxing jurisdictions. Foreign tax credit issues are contentious and may interfere with otherwise satisfactory relations between tax authorities. Moreover, foreign tax credit issues are complex and many close and difficult questions arise which must be resolved in order to decide whether under the Internal Revenue Code a given payment is creditable. Reasonable men can and do differ on whether specific foreign tax credit decisions are "right." On the other hand, as I have stated, any foreign country can impose a creditable tax if it follows the proper structure. Under these circumstances and in order to fulfill the other purposes of a tax treaty, the Treasury is prepared to resolve foreign tax credit issues by negotiation.

In the case of the pending tax treaty between the United States and the United Kingdom, a credit is allowed for the United Kingdom Petroleum Revenue Tax ("PRT"). At the time of the negotiation of the treaty the IRS was of the view that the PRT was not a creditable income tax. Revenue Ruling 78-424 formally takes the position that the PRT is not creditable. The Senate has ratified the provisions of the U.K. treaty dealing with the PRT and we have undertaken to change the relevant treaty provisions to ensure that the credits allowed by treaty will apply only to oil and gas income from the United Kingdom.

Treasury's decision to credit the PRT by treaty was based on the above-mentioned tax policy grounds, not on any perception of what U.S. international energy policy is or should be. The Treasury is not utilizing or advocating the use of tax treaties to foster or promote U.S. energy policy. Of course we are aware that assuring a credit by treaty might have a positive effect on the development or prosperity of business activity in a treaty country. The grant of the PRT credit in the U.K. treaty might well have avoided drilling delays or even stimulated companies to enter that market.

It is difficult to assess the importance and effect of a treaty credit in these terms, however. A company takes into account many factors before beginning oil operations in a given place and the foreign tax credit is but one of those factors. Moreover, while a company is not worse off if a payment is creditable rather than noncreditable it is not necessarily the case that a company is better off if it receives a credit for an otherwise noncreditable payment. For example, an oil company that is already in an excess credit position under Code section 907 does not receive a benefit by having more of its payments made creditable by treaty. Also, if a foreign tax credit is not available for a given payment a company may have other means to make itself whole. For example, if a credit is disallowed a company might be able to maintain its after tax profit position by either negotiating a lower purchase price with the foreign sovereign or by passing on to consumers the additional cost of doing business.

There are problems in the suggestion that the tax treaty credit mechanism be utilized to encourage the development of energy resources in certain countries. First and foremost, it is not clear what criteria would or should be used in selecting such countries. These criteria would have to be developed.

A second issue to consider is that a tax treaty is a comprehensive arrangement. A wide range of issues is considered, and concessions are made by both countries. They are generally without regard to the type of industry. If too much pressure is put on one industry because of ancillary considerations -- no matter how valid -- it may be that there would be problems in avoiding double taxation with respect to other types of taxpayers. It may be that energy policy considerations pursued with respect to a given country would prejudice Treasury's ability to obtain tax benefits with respect to other activities in that country.

A basic problem with the possible utility of a tax treaty as an instrument of energy policy is that the U.S. tax treaty network covers very few developing countries and oil exploration is occuring in many such countries. U.S. tax policy considerations -- such as the refusal to give tax sparing -- have dissuaded many developing countries from entering into treaties with the U.S. It is unlikely that a policy of granting foreign tax credits for otherwise non-creditable oil company payments would significantly alter this state of affairs.

Further, the negotiation and ratification of tax treaties takes considerable time -- from two to five years in many cases (and sometimes longer). Energy policy makers will have to consider whether under these circumstances a tax treaty is a viable vehicle for their purposes.

Finally, there is the possibility that tax and energy policies will be in conflict. For example, the tax policy of assuring that business profits are taxed on a net basis, after deduction of significant expenses, could conflict with an energy policy that would credit payments by treaty even if imposed on gross business income or even if the payments are not taxes at all (*e.g.*, royalties). Any such conflicts would have to be resolved.

In summary, although the tax treaty network could theoretically be used to further energy policy goals, there are a number of difficult problems which raise doubts about the practical utility and effectiveness of such an approach.

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

FOR IMMEDIATE RELEASE March 12, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,000 million of 13-week Treasury bills and for $3,002 million of 26-week Treasury bills, both series to be issued on March 15, 1979, 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 14, 1979			26-week bills maturing September 13, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.620	9.415%	9.81%	95.238	9.419%	10.06%
Low	97.600	9.495%	9.89%	95.207	9.481%	10.12%
Average	97.605	9.475%	9.87%	95.219	9.457%	10.10%

Tenders at the low price for the 13-week bills were allotted 28%.
Tenders at the low price for the 26-week bills were allotted 98%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 30,275,000	$ 30,275,000	$ 21,760,000	$ 21,760,000
New York	4,561,730,000	2,550,530,000	4,408,620,000	2,645,220,000
Philadelphia	31,645,000	31,645,000	12,405,000	12,405,000
Cleveland	27,930,000	27,930,000	39,180,000	38,980,000
Richmond	24,290,000	24,290,000	27,405,000	27,385,000
Atlanta	26,835,000	26,835,000	20,715,000	20,715,000
Chicago	216,050,000	91,050,000	157,900,000	52,900,000
St. Louis	46,860,000	28,420,000	38,650,000	19,650,000
Minneapolis	7,255,000	7,255,000	3,430,000	3,430,000
Kansas City	33,885,000	33,885,000	26,925,000	26,925,000
Dallas	14,845,000	14,845,000	6,695,000	6,695,000
San Francisco	224,865,000	119,865,000	215,625,000	110,025,000
Treasury	13,515,000	13,515,000	15,560,000	15,560,000
TOTALS	$5,259,980,000	$3,000,340,000a/	$4,994,870,000	$3,001,650,000b/

a/Includes $411,120,000 noncompetitive tenders from the public.
b/Includes $231,050,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

B-1453

DATE: March 12, 1979

	13-WEEK	26-WEEK
TODAY:	9.475%	9.457%
LAST WEEK:	9.364%	9.415%

HIGHEST SINCE:

8-26-74	9.908%	
2-26-79		9.498%

LOWEST SINCE:

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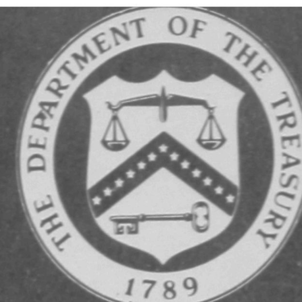


FOR RELEASE AT 4:00 P.M. March 13, 1979

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $5,900 million, to be issued March 22, 1979. This offering will result in a pay-down for the Treasury of about $200 million as the maturing bills are outstanding in the amount of $6,115 million. The two series offered are as follows:

91-day bills (to maturity date) for approximately $2,900 million, representing an additional amount of bills dated December 21, 1978, and to mature June 21, 1979 (CUSIP No. 912793 Z2 5), originally issued in the amount of $2,906 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,000 million to be dated March 22, 1979, and to mature September 20, 1979 (CUSIP No. 912793 2M 7).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing March 22, 1979. Federal Reserve Banks, for themselves and as agents of foreign and international monetary authorities, presently hold $3,520 million of the maturing bills. These accounts may exchange bills they hold for the bills now being offered at the weighted average prices of accepted competitive 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. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, 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, Monday, March 19, 1979. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

B-1454

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 in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders 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 on all accepted tenders 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. 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.

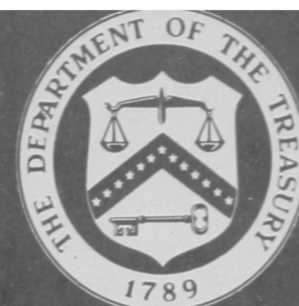
Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action 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 weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch or at the Bureau of the Public Debt on March 22, 1979, in cash or other immediately available funds or in Treasury bills maturing March 22, 1979. Cash adjustments will be made for difference between the par value of the 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 these bills 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 these bills (other than life insurance companies) must include in his or her 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 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 IMMEDIATE RELEASE
EXPECTED AT 1:00 P.M., EST
WEDNESDAY, MARCH 14, 1979

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES

Mr. Chairman. I am very pleased to appear before this Subcommittee to present the Administration's appropriations request for the multilateral development banks. With your permission, I propose to submit a comprehensive statement for the record and to introduce the discussion today by summarizing the principal points. I will lay out the budgetary requests, explain why we believe they are necessary and cost effective, and then report to you briefly on developments during the year on issues where you have expressed some concern.

This year we are requesting budget authority of $3.6 billion for the development banks. This consists of two parts: $1,842 million for paid-in capital subscriptions and for contributions to the concessional windows of the banks, which will eventually result in expenditures; and $1,782 million for callable capital subscriptions to the banks, which will not result in actual expenditures.

B-1455

The request breaks down as follows:

-- $1,026 million for U.S. subscriptions to the World Bank's capital. Ten percent of this amount, or $102.6 million would be paid-in. With this subscription, and those of other member countries, the Bank is able to borrow on private markets and relend the funds for development assistance projects at market rates of interest. The Bank has never had a default on its loans and earns money each year.

-- $1,092 million for U.S. contributions to the fourth and fifth replenishments of the International Development Association. IDA is the concessional loan facility of the World Bank. It lends money only to the poorest countries of the world. Of this total, $800 million is for this year's installment to IDA V, and $292 million is needed to complete the final installment of the U.S. contribution to the fourth replenishment, which was negotiated by the previous Administration. This year's total IDA request is $166 million less than what Congress actually appropriated for this institution last year.

-- $33.4 million for the third and final installment of U.S. contributions to the International Finance Corporation, the World Bank affiliate that encourages the growth of productive private enterprise in developing countries.

-- $687 million for the first installment of the U.S. subscription to the capital of the Inter-American Development Bank. Of this amount, 7.5 percent or $51.5 million is

paid-in. The Bank is a primary source of development lending in the hemisphere and the United States is its leading shareholder.

-- <u>$325 million for U.S. contributions to the Fund for Special Operations of the IDB, the Bank's soft loan window</u>. $175 million is for the first of four annual installments to the new replenishment, each of which calls for a lower U.S. contribution than was pledged to the previous replenishment. The remaining $150 million is for the final part of our contribution to the prior replenishment, which was negotiated by the previous Administration.

-- <u>$248 million for subscriptions to the capital of the Asian Development Bank</u>. Ten percent, or $24.8 million of this subscription will be paid-in. This Bank has established an excellent record and Japan has taken the lead in providing for its financing. Furthermore, European members have increased their proportionate share in providing funds.

-- <u>$171 million for U.S. contributions to the Asian Development Fund, the soft loan window of the Asian Development Bank</u>. $111 million is for the first installment of our contribution to the new replenishment and $60 million is for the final installment of our contribution to the present replenishment, which was negotiated in 1975.

-- <u>$42 million for the first of three annual installments to the African Development Fund</u>. This request will

enable the United States to provide a reasonable share of funding for concessional lending to the poorest African countries. It reflects our objective of taking a more active role in encouraging economic and social development in Africa.

This request of $3.6 billion in budgetary authority for the multilateral development banks is slightly more than last year's request of $3.5 billion. However, putting aside callable capital, the request would result in expenditures that would be $286 million less than the expenditures which would have resulted from last year's request.

Compared to last year's appropriation, expenditures resulting from this year's request would be up by $211 million, or 13 percent. This increase is the result of unfunded requests from prior years, which account for almost $500 million in expenditures (deriving from almost $1 billion of total budget authority). If we could clear up these unfunded amounts, the budgetary outlook for U.S. contributions to the multilateral development banks over the next few years would result in a fairly constant level of expenditures in nominal terms and a reduction in real terms.

This is the story on the level and breakdown of our budget request for FY 1980. It is a substantial sum. Let me tell you why I believe it is necessary and why it would be well spent.

First, helping the developing countries through participation in the banks advances important U.S. foreign policy and security interests. Our interests require the successful social and economic development of these countries. Many of these interests are shared by other industrial countries, and most importantly by many developing countries as well. These shared interests are the foundation for effective multilateral cooperation through the banks.

The United States has a great deal at stake in these countries. As recent events have clearly demonstrated, some occupy strategic geographic positions, and possibilities exist for unrest and conflict, which could carry dangers for many countries, including the United States. Furthermore, we need the cooperation of the developing world if we are to achieve such objectives as: halting the proliferation of nuclear weapons, limiting conventional armaments, combatting international terrorism, suppressing international drug traffic, controlling illegal migration, promoting human rights and protecting the global environment.

Our economic interests in the developing world are large and growing. As a group, these countries were a market for 30 percent of our exports in 1977, including $6.7 billion in agricultural commodities. They were the source for 24 percent of our imports in 1977, including tin, bauxite, rubber, manganese, and other critically needed raw materials. To ignore the developing countries is to ignore our own interests.

Second, we derive significant economic and financial benefits from the activities of the multilateral banks, which more than offset the budgetary burden of our contributions. In short we earn a good return on our investment.

These direct financial and economic benefits include contracts awarded to U.S. firms resulting from development projects financed by the banks, the purchase of other goods and services in this country derived from bank activities, and interest paid to U.S. holders of bank bonds. On a cumulative basis, the banks have returned in these kinds of benefits substantially more than the amounts which have been paid in by the U.S. Government. Thus our contributions to the banks have not been a problem for the balance of payments or a source of trouble for the dollar. Indeed, they have provided benefits for the U.S. economy in terms of jobs and our economic growth.

Looked at more broadly, the multilateral development banks have played a very constructive role in sustaining a smoothly functioning and growing world economy which in turn has helped our trade and employment. They are a central part of the system for economic cooperation which the United States worked hard to establish after

World War II and which we must continue to support strongly today. We live in an economically interdependent world, and we need to encourage and extend international cooperation on development, as well as trade and finance, if we are to deal successfully with our own economic problems.

Third, the banks have been effective instruments for promoting economic and social development and thus are contributing to a more tolerable world environment for this and coming generations.

Essentially these institutions apply banking principles to the achievement of development purposes. In this they are unique instruments in the annals of economic change, and they work. The projects they finance are soundly conceived, carefully supervised and well executed. Of course there have been exceptions, but they are comparatively few and the average quality has been high indeed.

One of the principal U.S. objectives in the banks is to encourage and expand the use of resources to assist the poor -- not to finance a welfare program, but to raise productivity and increase employment opportunities. This requires the financing of the right mixture of projects to enlarge basic infrastructure, raise agricultural productivity, provide the basis for expanded employment in

urban areas and provide the foundation for the extension of essential social services.

The World Bank has been a leader in the effort to reach the poor, and progress is continuing. During the Bank's last fiscal year, 31 IDA projects amounting to $867 million were approved for rural development lending alone, with benefits going mostly to small farmers, tenants, and landless laborers. Emphasis is being placed on helping the urban poor through projects which provide sites and services for housing and through the encouragement of labor intensive industries.

In the Inter-American Development Bank, the recently negotiated replenishment agreement explicitly provides that 50 percent of all Bank lending -- conventional and concessional -- will benefit low income groups. In addition, the agreement requires that concessional resources from the Fund for Special Operations be effectively targeted at the poorest countries and the poorest people of the hemisphere.

While we have devoted a great deal of effort to encourage movement in this direction, we recognize that the banks must maintain a balanced approach to growth and development. Lending for transportation, communications and electric power will continue to have high priority. Infrastructure and basic needs projects depend on each other.

We strongly support and give high priority to the expansion of Bank lending for energy development. In response to a request made at the Bonn Summit Meeting, the World Bank explored new approaches to help solve the growing energy problems of developing countries and proposed an expanded lending program to do this. The United States has endorsed the general provisions of that program, including Bank financing for geological and geophysical surveys and exploratory drilling, and an acceleration in lending for projects to develop and produce gas and oil. By 1983, the World Bank Group expects to be lending $1.5 billion a year for this program, which would amount to more than 10 percent of its total lending. Over the next few years, the Inter-American Development Bank will be devoting a large proportion of its lending to help finance hydroelectric, geothermal and other aspects of energy development in Latin America, and the Asian Development Bank has also embarked on a large lending program to finance the production of primary energy fuels. These Bank funds, moreover, will facilitate additional private investment in this critical area, thus helping to meet urgent requirements in the developing countries, and improving the oil supply and demand balance for the world as a whole.

Fourth, the Banks are an unusually effective means for sharing the development assistance burden among the better-off countries.

Currently the United States provides one-fourth of the total funding requirements for these institutions, while other countries provide three-fourths. In contrast, the United States, twenty-five years ago, provided about two-thirds of total foreign economic assistance. Countries that once received assistance are now major sources of assistance, and this encouraging process continues today.

Consequently, our participation in the multilateral development banks has proven to be increasingly cost effective. Our foreign assistance dollar is stretched much further; it has greater impact and does more good for us and the developing countries as a result of our participation in the banks. These substantial benefits, however, require that the United States contribute its fair share of total resources. For example, if we do not contribute $800 million to this year's installment for IDA V, other countries' shares would not become available for commitment and IDA lending would have to stop. In the case of the remaining U.S. share of IDA IV, funds are needed to meet

disbursement requirements on past commitments. Under the replenishment arrangements in the Inter-American Development Bank, the Asian Development Fund and the African Development Fund, other countries may reduce their contributions if we do not provide ours in full.

Direct budgetary costs are even more greatly reduced by the banks' extensive use of callable capital for subscribing to new shares. This type of capital is not paid in to the banks. In the case of the United States, it never leaves the Treasury Department and does not result in any budgetary outlay. These subscriptions, however, serve as backing that enables the banks to borrow in the world's private capital markets. Callable capital would result in a budgetary outlay only in the event it were needed to cover a bank default on an obligation to bondholders. Such a call has never taken place in the past. In view of the banks' excellent financial record, their paid-in capital, and their large reserves from past earnings, the possibility of a call taking place in the future is remote.

Under typical capital replenishment arrangements,

nine out of ten dollars for conventional lending are raised by the banks in this way, enabling us to achieve very large budgetary savings without restricting the flow of needed resources to developing countries. In the case of the World Bank, total U.S. paid-in capital contributions of $884 million have generated more than $45 billion of lending, a leverage factor of 50 to 1. Moreover, the value of our shares is not only still intact, but it has been increased as a result of past earnings.

In the next subscription to the Inter-American Development Bank, the paid-in portion will be reduced from 10 percent to 7-1/2 percent. This will provide additional leverage in the use of U.S. budgetary expenditures to help finance this Bank. It is our intention to seek further reductions in the paid-in portions of future capital subscriptions of other banks, consonant with their growing financial strength.

Have domestic social programs suffered as a result of our foreign assistance program? I do not believe so. Only one-fourth of one percent of our Gross National Product goes for foreign economic assistance, including our participation in the multilateral development banks. This figure has declined in recent years and is now lower than the corresponding GNP shares for twelve of the

seventeen countries in the Development Assistance Committee of the OECD.

On the other hand, U.S. budgetary expenditures for domestic social programs have risen rapidly over the past decade. In 1965, expenditures for these programs amounted to $6 for each dollar of foreign aid. By 1969, this multiple had risen to $18 and by 1979 to $46. Funding for foreign economic assistance has not taken place at the expense of domestic social priorities. The question is not whether the United States can afford to fund foreign assistance programs, but rather can we afford not to. The answer clearly is no.

I turn now to report to you briefly on several matters on which the Congress has expressed special interest or concern.

Encouraging capital saving technology. There is a growing emphasis in the banks on encouraging the use of capital saving technologies. Use of such technologies is stimulated in the first instance by efforts to induce developing countries to adopt more realistic exchange rates and interest rates, thus eliminating an artificial premium on the use of capital rather than labor. What can be done on the individual project level has to be adapted to the differing circumstances in individual countries. In many cases these technologies are closely linked to the success of projects which are designed to benefit the

poor directly. One example is a recently approved IDB loan to El Salvador for community development in the economically deprived northwest region of the country. Its objective is to increase incomes and improve living conditions for 144,000 people in 300 small rural communities through self-help construction of small scale public works. The cost per beneficiary is not expected to exceed $80. Another example is an IDA credit to Upper Volta which is directed at rural and urban artisans and small scale entrepreneurs to encourage production of bricks, farm implements, wooden utensils, and pottery. The average cost per job is estimated to be less than $200.

Human Rights. We have sought to encourage greater regard for human rights in bilateral discussions with other countries, and in our actions in the multilateral banks. We have consulted with other member countries on human rights problems, and we have opposed, by voting against or abstaining on 50 loans to 15 countries.

We have also taken steps to implement the provision of last year's Appropriations Act which calls upon the Administration to seek adoption of human rights amendments to the banks' charters. In order to generate support for such amendments, we have consulted with countries that share our human rights concerns. Thus far, their reaction to this proposal has been negative. They believe that the introduction of such

amendments would be divisive, and that such amendments would not obtain the broad support required for their adoption. We are undertaking additional consultations to pursue this approach and to achieve the objectives of the legislation.

I would like to stress that the human rights provisions in current law are being carried out conscientiously. I see no need for change in the legislation. Indeed, as I have stated in the past, legislation prohibiting the use of U.S. contributions to the banks for loans to specific countries would mean that the contributions would have to be rejected by the institutions. This would jeopardize our continued participation in the banks at the expense of our human rights concerns and at enormous cost to our other foreign policy objectives.

Salaries. A great deal of work has been done in constructing a rational and objective system for determining World Bank and IMF salaries. A set of recommendations to this end has been made by a Joint Committee of these two institutions after one and a half years of study, which included the employment of professional compensation firms. These proposals are now being considered by the Boards of the two institutions, and we are working with other member governments to resolve this issue.

Accountability. We have greatly increased the flow of information to the Congress on the activities of the banks, and we have encouraged greater public dissemination

of bank documents. During the past year, the General Accounting Office completed studies of evaluation and review units within the banks and generally found them to be effective.

Commodity Issues. Current law requires that the United States oppose use of MDB funds for the production of any commodity for export if it is in surplus on world markets and if substantial injury would be caused to U.S. producers of the same, similar or competing products. It also provides that the President shall initiate international consultations to develop standards governing the allocation of development assistance for production of commodities in surplus on world markets where increased exports would cause substantial harm to other producers.

As a matter of fact, the banks have been making very few loans that could fall under these provisions. This is understandable because the banks themselves believe that loans to finance commodities in prospective world surplus would be a wasteful use of development assistance resources. To carry out the legislative requirements, we have established criteria to determine the economic impact of commodity loans on the world markets. No loan proposals thus far this year have required special action. We have also raised

internationally the question of establishing standards governing the use of development assistance resources for commodity loans and will report to you further on this matter.

I do not believe additional legislative action on commodity issues is warranted. In particular, legislation to prohibit the use of U.S. appropriations to the banks to finance specific commodity projects would, as in the case of country restrictions, not be legally acceptable to the banks. Such a provision in U.S. law would seriously damage U.S. interests.

I would like to conclude, Mr. Chairman, by asking that we step back for a moment and consider these institutions from still another vantage point. The evidence shows that they are one of the great success stories of the entire post-war period, stretching from Bretton Woods to the present. Even now they are continuing to improve on this impressive record. They give us good value for our money, their net impact on the budget is small, and they bring substantial economic and political benefits. I ask for your support in making it possible for this good work to continue.

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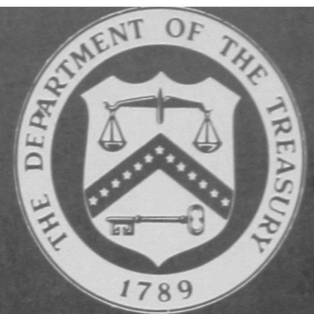

FOR IMMEDIATE RELEASE
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STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON FOREIGN OPERATIONS
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES

Mr. Chairman. I am very pleased to appear before this Subcommittee to present the Administration's appropriations request for the multilateral development banks. In my statement, I will lay out the elements of the request, explain why we believe they are necessary and cost effective, and then report to you in more detail on the reasons for our participation in the banks and on several issues about which you have expressed particular interest or concern.

This year we are requesting budget authority of $3.6 billion for the development banks. This consists of two parts: $1,842 million for paid-in capital subscriptions and for contributions to the concessional windows of the banks, which will eventually result in expenditures; and $1,782 million for callable capital subscriptions to the banks, which will not result in actual expenditures.

The request breaks down as follows:

-- $1,026 million for U.S. subscriptions to the World Bank's capital. Ten percent of this amount, or $102.6 million would be paid-in. With this subscription, and those of other member countries, the Bank is able to borrow on private markets and relend the funds for development assistance projects at market rates of interest. The Bank has never had a default on its loans and earns money each year.

B-1456

-- $1,092 million for U.S. contributions to the fourth and fifth replenishments of the International Development Association. IDA is the concessional loan facility of the World Bank. It lends money only to the poorest countries of the world. Of this total, $800 million is for this year's installment to IDA V, and $292 million is needed to complete the final installment of U.S. contribution to the fourth replenishment, which was negotiated by the previous Administration. This year's total IDA request is $166 million less than what Congress actually appropriated for this institution last year.

-- $33.4 million for the third and final installment of U.S. contributions to the International Finance Corporation, the World Bank affiliate that encourages the growth of productive private enterprise in developing countries.

-- $687 million for the first installment of the U.S. subscription to the capital of the Inter-American Development Bank. Of this amount, 7.5 percent or $51.5 million is paid-in. The Bank is a primary source of development lending in the hemisphere and the United States is its leading shareholder.

-- $325 million for U.S. contributions to the Fund for Special Operations of the IDB, the Bank's soft loan window. $175 million is for the first of four annual installments to the new replenishment, each of which calls for a lower U.S. contribution than was pledged to the previous replenishment. The remaining $150 million is for the final part of our contribution to the prior replenishment, which was negotiated by the previous Administration.

-- $248 million for subscriptions to the capital of the Asian Development Bank. Ten percent, or $24.8 million of this subscription will be paid-in. This bank has established an excellent record and Japan has taken the lead in providing for its financing. Furthermore, European members have increased their proportionate share in providing funds.

-- $171 million for U.S. contributions to the Asian Development Fund, the soft loan window of the Asian Development Bank. $111 million is for the first installment of our contribution to the new replenishment and $60 million is for the final installment of our contribution to the present replenishment, which was negotiated in 1975.

-- <u>$42 million for the first of three annual installments to the African Development Fund</u>. This request will enable the United States to provide a reasonable share of funding for concessional lending to the poorest African countries. It reflects our objective of taking a more active role in encouraging economic and social development in Africa.

This request of $3.6 billion in budgetary authority for the multilateral development banks is slightly more than last year's request of $3.5 billion. However, putting aside callable capital, the request would result in expenditures that would be $286 million less than the expenditures called for in last year's request.

Compared to last year's appropriation, expenditures resulting from this year's request would be up by $211 million, or 13 percent. This increase is the result of unfunded requests from prior years, which account for almost $500 million in expenditures (deriving from almost $1 billion of total budget authority). If we could clear up these unfunded amounts, the budgetary outlook for U.S. contributions to the multilateral development banks over the next few years would show a fairly constant level of expenditures in nominal terms and a reduction in real terms.

This is the story on the level and breakdown of our budget request for FY 1980. It is a substantial sum. Let me tell you why I believe it is necessary and why it would be well spent.

<u>First, helping the developing countries through participation in the banks advances important U.S. foreign policy and security interests</u>. Our interests require the successful social and economic development of these countries. Many of these interests are shared by other industrial countries, and most importantly by many developing countries as well. These shared interests are the foundation for effective multilateral cooperation through the banks.

The U.S. has a great deal at stake in these countries. Some occupy strategic geographic positions and possibilities exist for unrest and conflict, which could carry dangers for many countries, including the United States. Furthermore, we need the cooperation of the developing world if we are to achieve such objectives as: halting the

proliferation of nuclear weapons, limiting conventional armaments, combatting international terrorism, suppressing international drug traffic, controlling illegal migration, promoting human rights and protecting the global environment.

Our economic interests in the developing world are large and growing. As a group, these countries were a market for 30 percent of our exports in 1977, including $6.7 billion in agricultural commodities. They were the source for 24 percent of our imports in 1977, including tin, bauxite rubber, manganese and other critically needed raw materials.

Second, we derive significant economic and financial benefits from the activities of the multilateral banks, which more than offset the budgetary burden of our contributions. In short we earn a good return on our investment.

These direct financial and economic benefits include contracts awarded to U.S. firms resulting from development projects financed by the banks, the purchase of other goods and services in this country derived from bank activities, and interest paid to U.S. holders of bank bonds. On a cumulative basis, the banks have returned in these kinds of benefits substantially more than the amounts which have been paid in by the U.S. Government. Thus our contributions to the banks have not been a problem for the balance of payments or a source of trouble for the dollar. Indeed, they have provided benefits for the U.S. economy in terms of jobs and our economic growth.

Looked at more broadly, the multilateral development banks have played a very constructive role in sustaining a smoothly functioning and growing world economy which in turn has helped our trade and employment. They are a central part of the system for economic cooperation which the United States worked hard to establish after World War II and which we must continue to support strongly today. We live in an economically interdependent world, and we need to encourage and extend international cooperation on development, as well as trade and finance, if we are to deal successfully with our own economic problems.

Third, the banks have been effective instruments for promoting economic and social development and thus are contributing to a more tolerable world environment for this and coming generations.

Essentially these institutions apply banking principles to the achievement of development purposes. In this they are unique instruments in the annals of economic change, and they work. The projects they finance are soundly conceived, carefully supervised and well executed. Of course there have been exceptions, but they are comparatively few and the average quality has been high indeed.

One of the principal U.S. objectives in the banks is to encourage and expand the use of resources to assist the poor -- not to finance a welfare program, but to raise productivity and increase employment opportunities. This requires the financing of the right mixture of projects to enlarge basic infrastructure, raise agricultural productivity, provide the basis for wider employment in urban areas and provide the foundation for expanding essential social services.

The World Bank has been a leader in the effort to reach the poor and progress is continuing. During the Bank's last fiscal year, 31 IDA projects amounting to $867 million were approved for rural development lending alone, with benefits going mostly to small farmers, tenants, and landless laborers. Emphasis is being placed on helping the urban poor through projects which provide sites and services for housing and through the encouragement of labor intensive industries.

In the Inter-American Development Bank, the recently negotiated replenishment agreement explicitly provides that 50 percent of all Bank lending -- conventional and concessional -- will go to low income groups. In addition, the agreement requires that concessional resources from the Fund for Special Operations be effectively targeted at the poorest countries and the poorest people of the hemisphere.

While we have devoted a great deal of effort to encourage movement in this direction, we recognize that the banks must maintain a balanced approach to growth and development. Lending for transportation, communications and electric power will continue to have high priority. Infrastructure and basic needs projects depend on each other.

Another high priority that we strongly support is the expansion of Bank lending for energy development. In response to a request made at the Bonn Summit Meeting, the World Bank explored new approaches to help solve the

growing energy problems of developing countries and proposed an expanded lending program to do this. The United States has endorsed the general provisions of that program, including Bank financing for geological and geophysical surveys and exploratory drilling, and an acceleration in lending for projects to develop and produce gas and oil. By 1983, the World Bank Group expects to be lending $1.5 billion a year for this program, which would amount to more than 10 percent of its total lending. Over the next few years, the Inter-American Development Bank will be devoting a large proportion of its lending to develop geothermal and hydroelectric potential in Latin America, and the Asian Development Bank has also embarked on a large lending program to finance the production of primary energy fuels. These Bank funds, moreover, will facilitate additional private investment in this critical area, thus helping to meet urgent requirements in the developing countries, and improving the oil supply and demand balance for the world as a whole.

Fourth, the Banks are an unusually effective means for sharing the development assistance burden among the better-off countries.

Currently the United States provides one-fourth of the total funding requirements for these institutions, while other countries provide three-fourths. In contrast, the United States, twenty-five years ago, provided about two-thirds of total foreign economic assistance. Countries that once received assistance are now major sources of assistance and this encouraging process continues today.

Consequently, our participation in the multilateral development banks has proven to be increasingly cost effective, providing a multiplier effect to the use of our development assistance appropriations. This substantial benefit, however, requires that the United States contribute its fair share of total resources. For example, if we do not contribute $800 million to this year's installment for IDA V, other countries' shares would not become available for commitment and IDA lending would have to stop. In the case of the remaining U.S. share of IDA IV, funds are needed to meet disbursement requirements on past commitments. Under the replenishment arrangements in the Inter-American Development Bank, the Asian Development Fund

and the African Development Fund, other countries may reduce their contributions if we do not provide ours in full.

Direct budgetary costs are even more greatly reduced by the banks' extensive use of callable capital for subscribing to new shares. This type of capital is not paid in to the banks. In the case of the U.S., it never leaves the Treasury Department and does not result in any budgetary outlay. These subscriptions, however, serve as backing that enables the banks to borrow in the world's private capital markets. Callable capital would result in a budgetary outlay only in the event it were needed to cover a bank default on an obligation to bondholders. Such a call has never taken place in the past. In view of the banks' excellent financial record, their paid-in capital, and their large reserves from past earnings, the possibility of a call taking place in the future is remote.

Under typical capital replenishment arrangements, nine out of ten dollars for conventional lending are raised by the banks in this way, enabling us to achieve very large budgetary savings without restricting the flow of needed resources to developing countries. In the case of the World Bank, total U.S. paid-in capital contributions of $884 million have generated more than $45 billion of lending, a leverage factor of 50 to 1. Moreover, the value of our shares is not only still intact, but it has been increased as a result of past earnings.

In the next subscription to the Inter-American Development Bank, the paid-in portion will be reduced from 10 percent to 7-1/2 percent. This will provide additional leverage in the use of U.S. budgetary expenditures to help finance this Bank. It is our intention to seek further reductions in the paid-in portions of future capital subscriptions of other banks, consonant with their growing financial strength.

Have domestic social programs suffered as a result of our foreign assistance program? I do not believe so. Only one-fourth of one percent of our Gross National Product goes for foreign economic assistance, including our participation in the multilateral development banks. This figure has declined in recent years and is now lower than the corresponding GNP shares for twelve of the seventeen countries in the Development Assistance Committee of the OECD.

On the other hand, U.S. budgetary expenditures for domestic social programs have risen rapidly over the past decade. In 1965, expenditures for these programs amounted to $6 for each dollar of foreign aid. By 1969, this multiple had risen to $18 and by 1979 to $46. It is clear from these figures that funding for foreign economic assistance has not taken place at the expense of domestic social priorities.

In justifying the appropriations request I have emphasized four factors which constitute the rationale for continued U.S. participation in the banks: foreign policy and national security considerations, economic and financial benefits, the overall effectiveness of the banks in lending to promote growth and reach the poor, and the cost effectiveness of our subscriptions and contributions. At this time, I would like to discuss each of these matters in more detail and then report to you further on several other issues including use of capital saving technologies, salaries, human rights, accountability, and commodities.

FOREIGN POLICY AND NATIONAL SECURITY CONSIDERATIONS

The more than one hundred developing nations contain the great majority of the world's population. They differ greatly among themselves in terms of culture, history, political systems and the level of economic development that they have attained. Nevertheless, they all share one major aspiration: economic growth and development and material improvement in the lives of their people.

The less developed countries have moved to the forefront of world affairs. They are increasingly active in international political and economic organizations and more effective in pursuing their national and regional interests. Collectively, and in some cases individually, they have assumed a much greater importance in U.S. foreign policy and national security considerations:

-- They are an important source of raw materials which are critical to the economies of the United States and other industrial countries.

-- They occupy strategic geographical positions.

-- They are growing users of atomic energy for peaceful purposes and a number of them have the capability for developing nuclear weapons.

-- They have military capabilities which can be used to initiate military conflicts affecting U.S. interests and having the potential of escalating into great-power confrontation.

-- Their growing populations and aspirations place greater demands on the earth's resources and environment on which we too must depend.

Negotiations toward the solutions to these problems are complex and difficult, requiring a balancing of interests and a sensitivity to the requirements of developing countries. In implementing non-proliferation policy, for example, it is necessary to recognize that less developed countries have a legitimate and expanding requirement for energy. In this particular respect, the IBRD Report on Energy and the recommendations it contained for project financing in this sector, have been very helpful. In order to combat international terrorism effectively, we must be able to count on the support of less developed countries in multilateral organizations such as the U.N. and in dealing directly with individual situations as they may arise. The Law of the Sea Conference now going on under the auspices of the United Nations requires the cooperation of less developed countries on a number of issues if we are to reach agreement and still protect interests of the United States relating to navigation, marine research, protection of the environment and exploration and exploitation of deep seabed mineral resources.

In this general context of competing and conflicting interests on major international issues, the multilateral development banks provide the United States with a practical and effective way to work cooperatively with developing countries to help them meet their most basic aspirations. However, our relationships with less developed countries are also important on an individual basis. The following four examples illustrate how multilateral development bank activity contributes to the achievement of U.S. policy objectives in specific countries.

Thailand

Thailand has a central position in southeast Asia and has maintained a close relationship with the United States. It is in our national interest to support the stability and independence of Thailand because it is a key element of regional progress and balance in southeast Asia. Thailand's cooperation is essential if we are to have an effective narcotics suppression program. It has also provided a country of first refuge for Indo-Chinese refugees. Thailand is important as an expanding market for U.S. exports including cotton, tobacco, machinery, fertilizers, iron, and steel. It is also a reliable supplier of critical raw material imports such as tin, tungsten and rubber.

Economically, Thailand has grown at a rate matched by few developing countries. From 1960 to 1976, GNP growth averaged 7.6 percent a year. A high and rising level of investment has been maintained, exceeding 20 percent of GNP and largely financed by domestic savings. Per capita income doubled over the 1960-1976 period. Inflation has been kept under control by conservative fiscal policies, although price pressures have recently intensified.

In the past, economic policies have tended to favor Bangkok, other urban areas and the relatively better off farmers of the central plains. A large proportion of the rural population, particularly in the northeast, has not shared equitably in the benefits of economic growth. Failure to remedy the growing disparity has fostered insurgency and hindered political stability.

The present government in Thailand is beginning to reorient economic policy more in favor of these elements of the rural population. The Prime Minister has declared 1979 the "Year of the Farmer" and has stated his government's intention to direct far greater resources to rural areas. The revised Five-Year Development Plan for 1977-1981 calls for external borrowing of about $1 billion per year to finance rural and infrastructure development to bring services and improved agricultural technology to the rural poor.

For 1979, the proposed borrowing program includes $314 million from the IBRD and $324 million from the ADB. It is in our interest that the flow of financing

continue to Thailand. Our participation in the banks will help assure that the country will be able to sustain its growth and carry out needed changes in its overall economic policies.

Mexico

Mexico provides another example of how a country which is critically important to the United States benefits from multilateral development bank activities.

Mexico's importance to the U.S. stems primarily from its geographical proximity to this country, and the influence which this proximity can have on the political, economic, social, environmental and security aspects of American society. Two fundamental U.S. policy objectives which flow from this basic fact of life are:

-- Political stability and economic growth in a Mexico which is friendly to the United States.

-- Control of migration which if not controlled, has potentially disruptive effects for the United States.

In addition, the development of Mexico's hydrocarbon resources will increase the free world's supply of oil and provide Mexico with the revenue to increase domestic employment, thus reducing migration pressures on the United States. Finally, cooperation between our two countries is necessary for narcotics control and other border issues including sanitation, pollution control, and law enforcement.

Mexico does not receive concessional lending from either the IBRD or the IDB. It has become, in fact, a donor to the Fund for Special Operations of the IDB. It continues, however, to receive substantial amounts of market rate financing from the banks. In their most recent fiscal years, World Bank loans to Mexico amounted to $469 million while those of the Inter-American Development Bank were $238 million. President Carter, during a recent trip to Mexico, visited an integrated rural development project which is being financed jointly by the banks. The purpose

of the project is to increase incomes and employment opportunities for poor people in rural areas of the country. The banks thus play a very useful financial intermediary role in Mexico, and they provide a source of advice on investment plans which may help Mexico to use petroleum revenues most effectively to solve unemployment and under-employment and redress social and economic imbalances.

Tanzania

Tanzania is one of the world's poorest countries. However, it has taken a prominent position in regional and international organizations and is recognized as a leader in Africa and in the Non-Aligned Movement. President Nyerere is Chairman of the Front Line States and U.S. officials have worked with him concerning very sensitive problems relating to Rhodesia and Namibia.

President Nyerere and his government have advanced a national development strategy which emphasizes "self reliance". Their philosophy has entailed the organization of the rural population into "ujamaa" villages, and attempting to provide education and other services on a limited but equitable basis. The World Bank has worked closely with Tanzania in devising and implementing its rural development strategy which is aimed at reaching the poor and helping to meet basic human needs. On a cumulative basis, it has committed $605 million to Tanzania, including $353 million on concessional terms.

ECONOMIC AND FINANCIAL BENEFITS

U.S. participation in the multilateral development banks is a long-term investment in the future of the developing world. Although the most important benefits to the United States are long-term, we clearly derive short-term benefits as well.

Increased financing to the developing countries permits them to increase their imports of investment goods from the United States and other developed countries directly. As a result of the increased investment, the developing countries are able to improve their living standards more rapidly, providing a growing market for the United States and other exporters.

This investment also helps developing countries produce raw materials the United States must import in order to prosper.

Exports to developing countries resulting directly from multilateral development bank loans and from the more rapid expansion of living standards are a growing source of demand for U.S. goods and services. This provides jobs, income, profits, and tax revenue in the United States.

From the time of the banks' inception in 1946 to the middle of 1978, direct accumulated receipts by all segments of the U.S. economy have exceeded outflows to the MDBs by $2.4 billion. In addition, an econometric analysis which we have made shows that real GNP increased annually between $1.2 billion and $1.8 billion as a result of exports of U.S. goods and services to markets directly created by MDB financed projects in developing countries. This means that every U.S. dollar paid into the MDBs generated between $2.39 and $3.38 in real U.S. economic growth annually over the period.

U.S. participation in the multilateral development banks is not motivated primarily by these kinds of benefits. But it is a mistake to view outlays to the multilateral development banks as an economic loss to the United States.

A large proportion of the direct economic and financial benefits that have accrued to the United States have been in the form of contracts awarded to U.S. firms for loan projects financed by the banks overseas. As a general matter, our cumulative procurement shares from the banks have been in line with our share of contributions: 25 percent in the World Bank, 50 percent in the Inter-American Development Bank and 8 percent in the Asian Development Bank.

In the case of the Asian Development Bank, procurement has been less than the level of our expectations. Consequently, we established an inter-agency working group to study the reasons for the disparity and to take appropriate actions. The working group, consisting of representatives from Treasury, Commerce and the State Department's East Asia and Economic Bureaus, took the following actions:

-- Distributed a questionnaire to 300 U.S. consulting firms eliciting information on weaknesses in the system for providing information about upcoming contracts

-- Conducted a bid-by-bid review of the award of 1500 contracts let by the Asian Development Bank. The review indicated that U.S. firms bid on 300 of these contracts, a bid rate of 20 percent, and that they won 100 of the contract awards for which they had bid, an award rate of 33 percent.

-- Arranged for a meeting of regional economic and commercial counselors which is to take place in Manila to be built around the theme of increasing U.S. ADB procurement.

-- Promoted a series of ADB staff visits to U.S. Chambers of Commerce, mainly on the west coast, to advise U.S. firms of procurement opportunities in the ADB.

-- Sought additional opportunities for U.S. Government officials to talk to business groups about ADB activities. A Treasury official in recent months has briefed both business and trade groups in Georgia and Michigan on ADB procurement.

-- Persuaded ADB Management to provide copies of the Monthly Operations Report directly to interested businesses on a subscription basis.

-- Persuaded ADB management to publish all procurement notices in "Development Forum," published monthly by the U.N. as well as in the individual trade publications.

-- Established pilot programs for Economic and Commercial Counselors to monitor the preparation of specific project proposals.

As a result of the study, we have assured ourselves that the lending procedures of the ADB are fair to U.S. suppliers and that there is no institutional bias within the Bank which limits the success of U.S. suppliers. We see the problem as one of encouraging U.S. suppliers to bid more aggressively. Our role in solving this problem is making sure that potential U.S. suppliers have enough information as early as possible.

A system has been established within the office of the U.S. Director at the ADB to increase the flow of information to U.S. suppliers. Prior to Board consideration of each loan, a cable incorporating procurement information is sent to the U.S. Economic or Commercial Counselor in the recipient country and to the Commerce Department in Washington for dissemination to U.S. firms, including publication in Commerce Department periodicals such as Business America. We look forward to seeing improvement in U.S. procurement from ADB-financed projects as a result of the effort we are now making and as a result of currency realignments which should make American exports generally more competitive.

Within the Inter-American Development Bank, we are now pursuing a parallel program to increase U.S. procurement. A team of Commerce Department officials has consulted with the U.S. Executive Director and arrangements are being made for establishing a reporting system to advise U.S. Embassy economic counselors in Latin America of upcoming bank contracts similar to that which has been established for the Asian Development Bank. In recent months, the U.S. Alternate Executive Director of the IDB has participated in a number of meetings to advise U.S. businesses of procurement opportunities in Latin America through the Inter-American Development Bank and to assist U.S. businessmen in doing business through the bank.

A number of other actions have been taken which should be helpful in promoting U.S. procurement in the banks. A brochure outlining procurement opportunities and procedures and practices in all the banks has recently been revised and reissued. The banks themselves have prepared and provided detailed information on their lending activities and procurement eligibility requirements. This material is available directly from the banks or through the U.S. Executive Directors' offices. The Monthly Operations Report is now available on a subscription basis from the ADB as it has been for some time from the World Bank Group and we are hopeful that the Inter-American Development Bank will provide this material on a similar basis in the near future. The offices of the U.S. Executive Directors in all of the banks are extremely active in assisting U.S. businessmen and we have encouraged them to do more in this regard.

In the World Bank Group, recent examples of contracts awarded to U.S. firms include: $4.6 million to Ingersoll for miscellaneous goods and services in Korea, and $1.2 million to Southwire for electrical equipment in Brazil. Disbursements made between July 1, 1977 and June 30, 1978 on all World Bank Group contracts awarded to U.S. firms amounted to $1,447 million. Examples of contracts awarded from the Asian Development Bank include $7.2 million to the Vinnell Corporation for construction work in the Philippines, and $2.1 million to Phillips Brothers for copper wire. Examples from the Inter-American Development Bank include: $1.1 million to the Robins Company for equipment in Brazil and $2.0 million to the R.J.L. Hoste Company for construction in Guatemala. Smaller firms also benefit from awards of contracts for bank-financed projects.

REACHING THE POOR

The World Development Report, released by the World Bank last August, estimated that more than 800 million people of the developing world continue to live in conditions of absolute poverty -- that they are inadequately sheltered, malnourished, illiterate and diseased, with infant mortality rates in low income countries running far in excess of 100 for every thousand live births and life expectancies estimated at less than 44 years.

The very impressive growth rates of less developed countries in the last 25 years have not resulted in commensurate improvement in the lives of the absolutely poor. There has been increasing concern that much greater efforts must be made by the multilateral development banks and by other development assistance agencies to reach these people more directly and to involve them more productively in the development process. This Administration supports greater efforts by all the development assistance organizations to reach the poor in recipient countries. We have urged the World Bank and the regional development banks to take a number of actions to improve appraisal, implementation and evaluation of projects designed to reach the poor.

At the same time we recognize that a great deal of progress has already been made. During the Annual Meeting of the World Bank Group in Nairobi in 1973, a number of objectives were established to change the Bank's lending practices over the following five year period: lending in the agricultural sector was to be increased by 40 percent and a minimum of 70 percent of all agricultural loans were to benefit small farmers. Both of these goals have been met and surpassed. Agricultural lending in the five year period 1974-78 was up 145 percent over the preceding five year period. Of 363 agricultural projects approved by the Bank in 1974-78, 75 percent contained a component explicitly directed at assisting small farmers. In more than 200 of these 363 projects, over half of the direct beneficiaries were expected to be members of the rural poor. Bank experts now estimate that as a result of these loans the incomes of over 10 million rural families will at least double.

The World Bank has also established a set of goals for addressing the problems of the urban poor and a number of projects have already been approved to provide sites and services for urban housing and to create additional employment opportunities. For the period 1976-80, the Bank intends to finance 50 urban projects and by 1981 to substantially increase the proportion of its lending through industrial development finance institutions which directly benefits the urban poor. Additional emphasis is being placed on labor intensive industries and finding ways to encourage artisan and cottage industries. The use of labor intensive methods and practices has been mandated where appropriate in the implementation of Bank projects and encouraged throughout the construction industries of recipient countries.

In spite of the progress that has been made and that which is programmed, there is no disagreement that the problems of absolute poverty will be with us far into the future. Indeed the World Bank itself estimates that it would take a massive effort to reduce the number of people in absolute poverty to the level of 400 million by the year 2000. We are convinced, however, that much more can be done to raise the productivity of poor people to increase their incomes and to provide them with improved access to public services.

We have worked along two basic tracks to promote this result. We have sought basic changes in the policies of the banks to ensure that they will devote an increasing share of their loans to help the poor directly. In the recently negotiated replenishment of the Inter-American Development Bank, for example, it was agreed that one-half of all lending over the next four years benefit low income groups in recipient countries. It was also agreed that the concessional resources of the FSO should be better targeted toward poor people and poor countries. In the first and second years of the replenishment, 75 percent of these scarce concessional foreign exchange resources must go to the poorest countries in the hemisphere. In the third and fourth years, this figure must be increased to 80 percent. Any of the remaining FSO funds which go to other countries must be used only for projects which demonstrably benefit low income groups.

To assure that these results are achieved, the Board of Governors of the Bank has directed that the Board of Executive Directors prepare and submit by this June a report which will define precisely the groups which are to be benefitted with these resources. In addition, it should be noted that Bank management has already taken a number of steps to improve its capacity to reach low income groups. A clear statement of the intended beneficiaries of each project, the justification for the use of FSO resources and a description of land tenancy, in the case of agricultural loans, is now required in all loan documents. The Bank has also established a Small Project Financing Program which will enable it to respond to the needs of low income groups on a pilot basis and in innovative ways outside the regular lending program constraints.

In the Asian Development Bank, we took a very active role in seeing that the Bank's Board of Directors adopted an Agricultural Sector Paper based on the results of the Second Agricultural Survey which was carried out last year at Bank initiative and expense. Among other things, the paper provides the following guidance for future lending in agriculture: improved design of projects

to assure more rural employment opportunities, concentration on rural infrastructure including feeder road networks; better support facilities for rural credit programs and improved arrangements for providing inputs and for marketing production; establishment and upgrading of extension services for rural women; strengthening small scale enterprises and better provision for health, nutrition and family planning assistance. In addition, it calls for more of an orientation toward helping to meet basic human needs of the rural poor, encourages the participation of the under-employed in bank-financed projects, and requires that projects emphasize cost-reduction through calculations of project-cost per beneficiary.

The banks have proceeded along three lines toward the objective of further benefitting the poor.

First, the banks are using their considerable aid leverage to promote policy changes in the borrowing countries to improve the lot of the poor. As part of this approach, much greater effort is currently being made to involve the poor themselves in the planning and implementation of development projects. Examples of these efforts exist in all the multilateral development banks.

In February 1978, the International Development Association approved an $8.5 million credit to Cameroon for integrated rural development in the economically deprived eastern province of the country. This loan, which is to provide assistance through a provincial development organization (ZAPI), places particular importance on getting the full cooperation and participation of local farmers in all aspects of the project. ZAPI itself has set a long-term objective of eventually enabling the farmers to take charge of local development actions and has adopted a strategy aimed at creating a farmer controlled and operated cooperative structure. To this end, a system of farmer committees has been established to organize village marketing and to oversee disbursement and recovery of credits as well as to provide the farmers with a mechanism for influencing policy, planning and coordination of rural development activities in the province.

In September 1978, the Asian Development Bank made a loan of $18 million to Indonesia for an irrigation project. This loan also emphasizes the need for active involvement of farmers through local irrigation associations which are called Subaks. These organizations are traditional in some rural areas of Indonesia and include in their membership all cultivators who own, sharecrop or rent land receiving water from a single source. Each member of the Subak has an equal vote and the leadership is democratically elected by majority vote or consensus. The ADB loan agreement specifically requires that the Subaks be directly involved in the allocation of water between Subaks and in the settlement of inter-Subak water rights disputes.

A third example of involvement by the poor is an IDB loan of $13.2 million to El Salvador for community development. This loan, which was approved in November 1978, has been designed to benefit low income groups in the northwestern region of the country. It includes a sub-program of credits for production purposes to individuals or cooperative organizations and a sub-program of small scale public works such as school repairs and construction of feeder roads, bridges, community halls, public baths, washrooms and latrines. A central element of the project is the provision for beneficiary participation in setting priorities for the small scale public works and for giving the beneficiaries the opportunity to work on the implementation of these works.

Second, the multilateral development banks have shifted the sectoral composition of their lending activity to favor projects which directly meet the needs of the poor. For example, World Bank Group lending for rural development increased over sevenfold from FY 1973 to FY 1978 from $247 million to $1,728 million. Similar sectoral changes are occuring in the regional banks as well.

In the Asian Development Bank, for the year 1977, the percentage share of agricultural projects was 29 percent, up from 26 percent in 1976. In 1978 more than 53 percent of the bank's concessional lending to the poorest countries of the region was for agricultural purposes. In the IDB at the end of 1977, bank lending going directly for agricultural

purposes accounted for 23 percent of the total loan portfolio. In 1978, there was an increased concentration on approval of integrated rural development projects which are mandated to rise in the period 1979-1982 since, under the upcoming replenishment, between 30 and 35 percent of bank lending has been expressly designated for rural development projects. A further 10 to 15 percent is targeted for urban development projects.

Third, the MDBs are changing the emphasis of their more traditional projects to assure that their benefits are shared by the rural and urban poor. In the design of water supply, electrification and road projects, for example, the benefits accruing to poorer groups have been considerably expanded.

Two specific recent examples come to mind. An IDB loan of $12.2 million to Ecuador for a rural water supply system has been aimed at several communities in El Oro province where 90 percent of the population have incomes less than the national average income. An ADB loan of $24.0 million to the Philippines has been designed to support construction of secondary and feeder roads in the island of Mindanao, a particularly disadvantaged area of the country. It has been estimated that, in addition to net value added through incremental agricultural production and user cost savings, the project will also benefit 42,000 families with a population of 270,000 in the area of influence through improved availability of governmental social and administrative services, a favorable effect on school enrollments and greater access to health services.

An important problem is how best to develop a capacity to discover "who actually benefits" from MDB projects. Considerable effort has been made by the banks in the last several years to improve the data gathering procedures and statistical analysis capabilities of the borrowing countries. This effort is a vital ingredient of the banks' programs to know whether they are in fact better reaching the poor, and how to assure that they will do so in the future. These statistical and analytical

techniques are now receiving greater attention, along with shifts in sectoral priorities and redesign of traditional projects.

There is substantial evidence that the multilateral development banks have made considerable progress in recent years in better reaching the poor.

The most recent statistics for IDA indicated that during FY 1978 50 agricultural projects amounting to $1,341 million were approved, accounting for nearly 58 percent of total IDA lending. Of these projects, 31 amounting to $867 million were for rural development lending in which a majority of the direct benefits go to small farmers, tenants and landless laborers. Approximately 6.6 million rural families are expected to benefit directly from these 50 agricultural and rural development loans and of those families, two-thirds or 4.4 million, are either absolutely poor or in the lower third of the income levels for their particular countries. In addition to the direct beneficiaries, the World Bank staff estimated that 13 million other farm families should benefit from the projects through advances such as improved research, storage, seed supply, and marketing facilities as well as from increased employment opportunities or from the provision of health and education services or improved transportation and other rural infrastructure.

These efforts to reach the poor are essential. At the same time, we believe that the multilateral development banks must also continue to pursue a multiplicity of goals if they are to be effective catalysts for development. The banks must preserve their recognized strengths in project design, sectoral and country programming, macro-policy leverage and infrastructure support. We would not want them to abandon these programs.

Infrastructure projects are still key in many less developed countries because they provide the necessary economic context for other assistance programs, including those to benefit directly the poor. For example, feeder roads serving small farmers in isolated parts of Africa must lead eventually to a principal road if inputs are to get in and production is to get out. Adequate port facilities are needed if fertilizers and other inputs from abroad

are to reach these smallholders and if their coffee or cocoa or other production is to have an export market. The smallholders themselves recognize that an improved transportation infrastructure is essential to reduce the disparities between farmgate and market prices. Indeed, the success of projects designed to meet basic human needs are often dependent upon these kinds of infrastructure projects. Hydro-electric power projects provide another example of projects which are critical if less developed countries are to meet expanding energy requirements and reduce their reliance on expensive imported fuels. The banks must combine projects such as these with the new emphasis on reaching the poor throughout the developing world in ways which promote both productivity and equity.

THE EFFECTIVENESS OF THE BANKS

The banks are very effective in promoting the economic growth and development of recipient countries. They raise resources for both concessional and near market lending operations from many donor countries. As a consequence, they are able to operate on a significant scale and across the range of economic sectors. Supported by a well qualified and experienced staff from more than 100 member countries, they have established a reputation for rigorous and detailed appraisal of project proposals and programs. The volume and range of their operations, and the expertise they can bring to bear, enable them to play a unique role in promoting economic growth and development. They have a capability and impact which is greater than that which any individual donor country can muster.

The multilateral development banks have become the leading institutions in the field of international economic development. They are now the largest source of official assistance to developing areas, last year making commitments for approximately $11 billion for over 400 projects in recipient countries. Actual disbursements exceeded $5.5 billion. This level of lending gives the banks important influence in recipient countries. Because of their apolitical character, and the fact that they operate on the basis of economic and financial criteria, the banks are able to encourage the adoption of appropriate economic policies.

They finance programs of technical assistance, to strengthen local institutions and provide training for local officials. They encourage coordination of the resource flow to developing countries and promote cooperation among official lenders by chairing aid coordination groups for particular countries. They also support research and development organizations, particularly in agriculture, and sponsor seminars and research on developmental problems, making the results available to interested individuals and groups.

In its most recent fiscal year, the World Bank Group approved total loans and investments amounting to $8,749.1 million. Of that amount, $6,097 million were for loans on near market terms, $2,313 million were for loans on concessional terms and $338.4 million were for investments by the International Finance Corporation. Disbursements from the Bank and IDA made during the year were $3,849 million. Technical assistance operations financed by the Bank included two loans amounting to $20.3 million and components of 151 other operations which amounted to an additional $230 million.

The Bank also maintained a leading role in the organization and operations of various aid coordination mechanisms. Under the auspices of the Bank, the Caribbean Group for Cooperation in Economic Development was established and held its first meeting in 1978. Formal meetings of ten other aid coordinating groups were held under Bank auspices during the year including groups for Bangladesh, Bolivia, Burma, Egypt, India, Nepal, Pakistan, Philippines, Sri Lanka, and Zambia. In addition the Bank participated in a meeting of the Inter-Governmental Group on Indonesia and hosted a meeting of donor agencies to discuss improving cofinancing and coordination of operations in the population sector.

In order to promote better inter-agency coordination, the Bank also entered into a formal agreement with the recently established International Fund for Agricultural Development (IFAD) on a working arrangement between the two organizations. The Inter-American Development Bank and the Asian Development Bank have entered into similar agreements with IFAD.

In addition, the World Bank became a co-sponsor for Research and Training in Tropical Diseases and IDA agreed to administer the Special Action Account of $385 million for the European Economic Community to provide

quick-disbursing assistance to the poorest developing countries. A number of ongoing programs and relationships were maintained with various U.N. agencies including the Food and Agriculture Organization, the World Health Organization, United Nations Industrial Development Organization, the International Labor Organization and the United Nations Education, Scientific and Cultural Organization.

During 1978, the World Bank also continued its support for eleven international agricultural research organizations providing $8.7 million to help finance the programs of organizations such as the International Institute of Tropical Agriculture in Nigeria, the International Livestock Center for Africa in Ethiopia, and the International Potato Center in Peru.

Eighty-seven economic research projects and studies were also underway in the IBRD during 1978. The results of these studies are available to the international research community and the public as well as to policy makers within the Bank and member countries. Examples of studies currently in process include strategies for control of tropical diseases such as schistosomiosis and the use of low cost technologies to provide safe drinking water and sanitation facilities. In addition, examinations are being made of small scale enterprises in selected countries and a number of surveys and studies are being conducted to provide a better analytical framework for providing rural development assistance.

The World Bank has also continued efforts to improve its systems for evaluating loan operations. In 1978, the Bank published an Operations Evaluation Department review of project performance audit results. The system for providing feedback to the operating departments from the audit process was strengthened through improvement in annual and semiannual procedures for reviewing completed and on-going projects. All Bank loans now require the borrower to complete a project completion report as a standard feature and in more difficult sectors -- such as agriculture, education and urban development -- the establishment of special monitoring units is required. In 1978, the Bank also sponsored a seminar on post-evaluation and review for senior officials of several African countries. As a result, discussions are continuing with those countries regarding establishing national agencies to evaluate public investment projects and similar seminars are planned for other regions.

Similar functions and activities are carried out by the regional development banks. For example, during 1978, the Presidents of these banks held one of their regular meetings at the headquarters of the Inter-American Development Bank to discuss major economic and financial issues facing developing countries. At this meeting they were joined by representatives from the World Bank, the International Monetary Fund, the European Economic Community, the European Investment Bank, the OPEC Special Fund and the Islamic Development Fund. During 1978, the IDB initiated joint financing with OPEC countries and organizations for development projects in Haiti, Bolivia, and Honduras. The Bank also sponsored symposia on the application of capital saving technologies and the prospects for greater use of solar energy. Last year, the Asian Development Bank held a seminar for regional development banks promoting improved appraisal and implementation of public and private investment projects. The Bank also completed a survey on South Pacific agriculture and sponsored a seminar on irrigation development and management.

COST-EFFECTIVENESS

The cost-effectiveness of U.S. participation in the multilateral development banks is based on three factors:

(1) Equitable sharing of the burden for providing economic assistance with other donor countries;

(2) Leveraging paid-in capital contributions to the banks by borrowings in private capital markets, based on callable or guarantee capital;

(3) Extending bank resources through cofinancing arrangements made with other official sources, including OPEC countries, and with private banks.

As I indicated at the beginning of my testimony, the United States has been able progressively to reduce its share of subscriptions and contributions to the banks and the shares of other participating

countries have been correspondingly increased. This process is continuing today. It reflects the growing economic strength of other countries and their increased capability to provide more resources for development. These countries include industrial countries such as Germany and Japan, the OPEC countries and some of the relatively more advanced developing countries such as Brazil and Mexico which have increased their convertible currency contributions to the Inter-American Development Bank.

During the past two years, this Administration has negotiated replenishment agreements for the International Development Association, the Inter-American Development Bank, the Asian Development Fund and the African Development Fund. In all of these agreements, except that for the African Development Fund, where the United States had hardly participated at all, the share of the United States has declined and the shares of other countries have increased.

As finally agreed in the spring of 1977, the fifth replenishment of IDA provided for a reduction in the U.S. share from 33.32 percent to 31.42 percent. Countries which increased their contributions to IDA V were Saudi Arabia, the United Arab Emirates and Kuwait. Germany and Japan, which had substantially increased the level of their contributions to the fourth replenishment, maintained this increased level during the fifth replenishment.

Subsequently, during the course of 1977 and 1978, a number of countries announced increases in their contributions to IDA V including Saudi Arabia, Kuwait, the Netherlands, Norway, and the United Kingdom. Altogether, these increased contributions amounted to $145.5 million with the largest sums coming from Saudi Arabia which contributed $100 million and Kuwait which contributed $20 million. As a result of these additional increased contributions the U.S. share of IDA V declined further to the level of 31.2 percent. In preliminary discussions for the sixth replenishment of resources, we are pursuing a sizable further reduction in line with the Sense of the Congress Resolution on shares contained in Title III of Public Law 95-481.

More equitable burden-sharing was one of the key elements in the recently completed agreement to replenish the resources of the Inter-American Development Bank, where our share is the largest because we are the only sizable industrial country in the hemisphere. Under the original terms of their entry into the bank in 1974, the non-regional members of Western Europe and Japan provided 4.4 percent of the Bank's total capital. In the agreement just negotiated, they raised the percentage share of their subscription to the increase by more than two and one-half times to 11 percent, pledging a total of $876 million in paid-in and callable capital which serves as backing on the Bank's borrowing operations. Under the agreement, Canada and Venezuela are contributing $310 million and $467 million respectively in paid-in capital and completely convertible backing for the Bank's borrowing operations. In addition, all of the recipient member countries of the Bank are making two-thirds of their paid-in capital fully convertible, thus mobilizing $178 million in convertible resources, including $43.5 million from Argentina, $43.5 million from Brazil and $28 million from Mexico, or a total of nearly $115 million from these three countries.

In the Fund for Special Operations, the Bank's concessional lending facility, the non-regional member countries maintained their entry share of 30 percent and increased their contributions from $450 million to $525 million. Canada, Venezuela and Trinidad and Tobago agreed to make all of their contributions fully convertible, providing $58.1 million, $70 million and $3.9 million respectively for a total of $132 million to these resources which are lent to the poorest countries in the hemisphere.

The three largest developing countries in the hemisphere, Argentina, Brazil and Mexico, agreed to make the equivalent of three-quarters of their FSO contributions convertible; thus they are contributing $72 million, $72 million and $46.5 million respectively. They have also agreed to continue not to borrow these convertible FSO resources. These three countries and Venezuela are all former recipients of FSO resources. They are now making convertible contributions to those resources of $260 million.

As a result of these contributions and those of the non-regional countries, the U.S. share of convertible FSO resources has dropped from 57 percent in the last replenishment to 45 percent in the new replenishment. In terms of absolute amounts, the annual level of U.S. contributions to the FSO will fall from $200 million under the last replenishment to $175 million under the new one, a reduction of 12.5 percent or $25 million per year in paid-in contributions to the concessional lending fund of the IDB.

In the Asian Development Fund, negotiations were completed last spring for a replenishment of resources of $2.0 billion, with the United States contributing $445 million, or 22.25 percent, and meeting the share standard established in last year's appropriations legislation. In addition, other donors agreed to make supplemental contributions of $150 million, thus effectively reducing the U.S. share to 20.7 percent, significantly below the standard set in last year's legislation.

Other donor countries have increased their percentage shares of contributions to the Fund. Japan, for example, originally on a par with the United States in contributions to the Fund, is contributing $673 million under the basic agreement and a supplementary amount of $118.3 million, for a total of $792 million or 36.8 percent of the total compared with our 20.7 percent. The Netherlands and Sweden also made marginal increases in their previous contributions and France, joining the Fund for the first time, provided an additional $104.8 million.

The other replenishment agreement negotiated by the Administration last year was for the African Development Fund. This Fund is relatively small and U.S. contributions in the past have been very minor, amounting to $50 million or well under ten percent of total Fund resources. In this particular case, the Administration agreed to a very substantial increase in the percentage share of our contributions to somewhat under eighteen percent although it is still a small amount in dollar terms ($125 million over a 3 year period) because the AFDF is still quite small itself.

We consider that this increase is fully justified on the grounds that Africa is the least developed continent, that it contains some of the poorest and least advantaged countries in the world, and that the African Development Fund has been steadily improving its administrative and technical capabilities. In the last two years, Africa has also assumed a much greater importance than before in the overall foreign policy of the United States. The announcement of the $125 million for contributions to the Fund was made last year at the time of President Carter's visit. It has been widely publicized in Africa and favorably interpreted as an indication of increasing U.S. interest.

USE OF CALLABLE CAPITAL

The second factor contributing to cost-effectiveness is the ability of the banks to use callable capital backing for bond issues, thereby permitting them to raise private capital for conventional lending, and avoiding budgetary outlay by the United States or other member countries. The ability of the banks to leverage limited paid-in contributions in this way has grown to the point where today, only one dollar in ten has to be paid-in and in the case of the IDB it is even less, as a result of the recent replenishment.

When the World Bank was first established in 1946, 20 percent of the capital was paid in and 80 percent was callable. The higher proportion of paid-in capital was necessary to cover start-up expenses, provide acceptable financial ratios and to secure confidence and support for the institution from private capital markets. As the Bank developed, it established a record for prompt collection and a reputation for financial prudence. It was possible to reduce the paid-in portion without damaging the Bank's ability to raise private funds at an acceptable cost. On a cumulative basis, the U.S. has paid in $884 million to the capital of the World Bank and, as a result of burden-sharing and leverage, supported a total lending program of over $45 billion. On this basis, each dollar of U.S. paid-in capital has been able to support approximately $50 in Bank lending. This pattern has been followed by the Inter-American Development Bank and the Asian

Development Bank, although because these institutions were not established until 1959 and 1966, and have different capital structures, the leverage factors have been lower.

In the case of the World Bank, we are now at the point when we can consider whether or not it is, in fact, necessary to continue to have 10 percent of the capital paid into the Bank under the next general capital increase. The final answer to this question depends, of course, on the views of all members and on the attitudes of private capital markets to this prospect. We ourselves would want to consider very carefully the implications that such a step might have for the Bank's financial strength, its cost of capital and the lending rate policy that it will follow in the 1980's. In any event, I am confident that it will be possible to reduce the paid-in portion of the next general capital increase below the ten percent level.

In the recently negotiated increase in capital of the Inter-American Development Bank, the financial strength of the institution made it possible to reduce the proportion of capital to be paid in. Under the terms of the agreement reached last December, the proportion of paid-in capital was reduced to seven and one-half percent.

On a cumulative basis, the U.S. has paid in $482 million to the IDB and supported a total capital lending program of nearly $7.0 billion, a combined leverage factor based on both burden-sharing and use of callable capital of 14 to 1. This is much lower than the multiple for the World Bank, but it reflects the fact that the Bank was not established until 1959 and that the United States until the 1970's was the only developed member country. The entry of the non-regionals and the increase in their capital shares in combination with a reduced paid-in portion will cause this multiple to become even larger in the future.

In the Asian Development Bank, the cumulative paid-in capital contributions of the United States amount to $242 million and they support a total lending program in excess of $3.8 billion, a leverage factor of 15 to 1.

COFINANCING

A third way in which our participation in the multilateral development banks is cost effective is through cofinancing or complementary financing arrangements made with private banks or other public and private organizations. The banks have been able to sell to commercial banks "participations" in the early maturities of their individual loans. These sales have been made without recourse and originally at the fixed interest rate set in each individual bank loan contract. This procedure had the advantage -- since it was done without recourse -- of freeing up Bank resources for additional lending. However, with the general rise and increased volatility of interest rates that has occurred during the 1970's, it has not been possible to continue these particular programs on the basis of a fixed rate.

As a result, the Inter-American Development Bank modified its participation program, introducing a variable interest rate feature. In the case of the World Bank, a parallel lending program was established with a cross-default clause to provide additional security for the commercial lender portion of the loan. This clause permits but does not make mandatory suspension of the entire loan, including the World Bank portion, if there should be a default on the portion of the loan held by the commercial bank. Under its new program, the World Bank had mobilized a total of $469 million in additional lending resources from private banks as of the end of calendar year 1978.

The figure of $469 million does not include the International Finance Corporation, which is also a member of the World Bank Group and which, under its mandate to encourage private enterprise in less developed countries, is very active in cofinancing. As of June 30, 1978, the IFC held investments amounting to more than $1,315 million of which $332 million or 25 percent were held for private purchasers and participants. On average, IFC financing in individual projects is held to 25 percent or less of total project costs and other resources have necessarily been mobilized including additional private or public capital from developed countries or from the recipient country itself.

IFC operations in the past have been most successful in middle income countries and in companies that have been in operation for some time. Following the recent increase in resources, however, it has been planned that operations in the poorer recipient countries will be increased. IFC will, therefore, perform a very useful role in putting together proposals which can attract additional private financing to countries, particularly in Africa and Asia, which have had difficulty in this respect in the past.

In the Inter-American Development Bank there is a complementary or cofinancing program based on sales of participations. There is no need for a cross-default clause, since the Bank administers the commercial bank portion of the loan, acting as disburser and collector. The Bank has had no difficulty in attracting commercial bank participation at interest rates which are agreeable to the borrowing countries and marginally lower than they would have received in the absence of the program, i.e., on a straight commercial loan basis. Since 1976, the Inter-American Development Bank has mobilized $278 million in additional lending resources through its complementary financing program. In both the World Bank and the Inter-American Development Bank, we anticipate that the amounts of money raised in this manner will rise in the future.

Participation in the cofinancing programs has not been limited to U.S. banks. Major banks from Germany, Japan, Switzerland and Canada, among other countries, have taken significant portions of individual loans. In addition to the resource extending beoefit, which is helpful to us for domestic budgetary reasons, there are other very definite advantages to the cofinancing programs. They provide a mechanism for introducing commercial bank lending in developing countries whose international credit standing has not been firmly established, thereby permitting these countries to enter the world financial system and pave the way for reducing still further, over time, the need for public aid. They also enable the multilateral development banks to lend in a larger number of sectors and for more projects, permitting a greater concentration of both conventional and concessional resources on projects which reach the poor, without requiring that critical infrastructure needs of recipient countries be abandoned or left unmet.

The Asian Development Bank has made less progress thus far than the World Bank and the Inter-American Development Bank in revising and expanding its private cofinancing program. At a recent Board of Directors meeting which considered a management proposal to take such action, the U.S. Director urged that greater emphasis be placed by the Bank on this cost-effective way of mobilizing additional resources for its developing member countries.

The Asian Development Bank has been more successful, however, in arranging cofinancing arrangements with other official sources such as the OPEC Special Fund, the Islamic Development Fund and individual OPEC countries. As of the end of calendar year 1978, the ADB had raised a total of $343 million in this manner. The Inter-American Development Bank has also helped the Venezuelan Government to establish a special Venezuelan Trust Fund of $500 million which is administered by the IDB for lending to other developing countries in the hemisphere. This Fund is in addition to Venezuela's regular contributions to the Bank's capital and to the Fund for Special Operations. World Bank figures show that cofinancing with OPEC countries and agencies amounted to $1.4 billion at the end of 1977, the most recent period for which data are available. Because its membership has been limited to the region, the African Development Bank has not tapped the international bond markets or sought to establish cofinancing relationships with commercial banks. If non-regional countries join the bank, which is a matter now under negotiation, however, the AFDB in the fuuure should be able to begin modest bond offerings based on the paid-in and callable capital contributions of developed member countries and may look toward the establishment of cofinancing relationships with commercial banks.

The United States has benefitted from increased burden-sharing and the mobilization of additional capital through bond offerings and cofinancing. As other countries have increased their contributions to the multilateral development banks, it has been possible for our overall share of contributions to decline. As the banks have established themselves in private capital markets, it has been possible for our overall paid-in capital contributions to be reduced from fifty percent in some cases to less than ten percent.

In comparison, the use of cofinancing has been more limited. I am hopeful that the World Bank and the Inter-American Development Bank will continue to expand their operations during this year and that the Asian Development Bank will be able to launch a new cooperative financing program with private banks as well as continue its relationships with public entities in the OPEC countries.

CAPITAL SAVING TECHNOLOGIES

A major U.S. objective in the banks is to promote projects which more directly and effectively reach the poor within beneficiary countries. One important means to help achieve this objective is to promote the utilization of capital saving technology in order to increase the productivity and incomes of poor people to insure that the greatest number of people benefit from bank projects, and to promote the most efficient use of scarce development resources.

Capital saving technologies involve the productive and often innovative use of small-scale and labor-intensive processes, techniques, equipment and tools which are less complex and costly than those usually employed in the developed countries. As a result, their application promotes the efficient use of available resources by substituting abundant unskilled labor for scarce investment funds. The approaches, activities, and techniques they embody also permit a focus on reaching the maximum number of beneficiaries at relatively modest assistance costs.

The United States has sought policy decisions through which the banks will place increased emphasis on the use of capital saving technologies in their projects. In November 1976, the Inter-American Development Bank adopted a policy to promote the use of light capital technology by making it a significant component of development strategy.

In 1977, the Asian Development Bank incorporated an enumeration and assessment of light capital technologies into its project identification and evaluation procedures so as to examine relevant technological alternatives as an ongoing part of its project selection process.

The World Bank's policy guidelines on the use of technologies are included in sector policy papers. For example, one of the major recommendations of the Bank's

1978 paper, Employment and Development of Small Scale Enterprises was that the Bank should urge recipient governments to correct policies and regulatory measures that have the effect of encouraging undue capital intensity in investments. The paper points out that larger firms may benefit more than smaller enterprises from credit programs with artificially low interest rates or from the subsidization of public services such as power, transportation and water supply. It concludes that these policies can be modified and that additional incentives can be provided in other ways such as reserving public procurement of certain items to smaller firms, encouraging subcontracting, and broadening the sectoral coverage of development finance companies.

We have has also sought to maximize the use of capital saving technologies in our review of individual loans. The Executive Directors in all of the banks, backstopped by Treasury staff, examine all loan proposals specifically to assure that this criterion is properly taken into account. They endeavor to promote the use of capital saving technologies in their contacts with other Board members, in communications with bank management and in discussions with technical staff. The U.S. concern for the application of capital saving technologies has been emphasized by our requesting clarification on the technological aspects and implications of individual projects presented to the Boards. For example, in connection with a fisheries loan to Ecuador, the United States Executive Director of the IDB sought and received assurance from the Bank that the craft to be used in the project were the most appropriate, least capital intensive alternative. In a feasibility study for a dam in the Dominican Republic, the Executive Director made sure that the guidance given to the consultants by the Bank included instructions to specifically take into account the possibilities for using light capital technologies in designing the project.

The banks, with U.S. support, are making increased efforts at the preinvestment stage to achieve a more effective application of capital saving technologies. By strengthening their project appraisal activities, the banks facilitate the selection of projects incorporating techniques that are most appropriate to the circumstances and requirements of the borrowing countries. In a large number of cases this leads to the utilization of light capital technologies.

The results of efforts to introduce capital saving technologies in appropriate instances can be seen in their increasing use in individual bank projects. An example is the recent IDB loan of $13.2 million mentioned earlier to support community development in the economically depressed northwest region of El Salvador. The objective of the project is to help bring about an improvement in the living conditions and incomes of approximately 144,000 people living in about 300 small rural communities through self-help construction of small scale works (roads, schools, bridges, potable water supply systems) and the granting of credit to approximately 48,000 low income people to increase their agricultural, agro-industrial and crafts production, facilitate the marketing of their products, and to meet other basic family needs.

The construction methods for the works subprogram will be labor intensive and use a high proportion of local materials. It is planned to limit the use of construction equipment to the minimum amounts necessary to assure a satisfactory output. In the credit assistance subprogram, the use of machinery will be limited to equipment that can be manually or easily operated, such as knapsack pumps, manual sprayers and sprinklers, and animal drawn plows. As a result of making this extensive use of local labor and materials in the works subprogram, the cost per beneficiary will not exceed $80.

An IDA credit for artisan small and medium scale enterprises in Upper Volta is an example of the World Bank's efforts to create employment by working through artisan groups and small scale enterprises. The project has three major components and all are expected to have important employment creation and institution building effects. One of these is for credit-in-kind and extension services to artisans. It amounts to $820,000 or 21 percent of the total credit and is based wholly on the provision of capital saving technology. The credit-in-kind will be largely raw materials such as wood, metal, and cement, and equipment such as wheelbarrows, shovels, axes, saws, molds and other basic tools. The average loan size is expected to be $400 with a range from a few dollars for working capital to a maximum of $8,000 for artisans. Extension officers will distribute raw materials and assist in planning and

implementing investments as part of their regular supervision visits to artisans. Artisan production will be bricks, farm implements, wooden utensils and probably pottery. Technical assistance to be provided for the artisans will include basic skill training, accounting for illiterates, general advice and direct marketing. The target group of recipients are rural and urban artisans with annual incomes of less than $400. Since a total increase in direct employment of 1,500 is projected, average investment cost per job will be less than $200.

The El Salvador and Upper Volta projects are two examples of efforts to reach the poor through capital saving technologies. The information for a detailed account of current efforts is presently being collected and will be included in our 1979 report to the Congress on the use of light capital technologies in MDB activities.

SALARIES

Another set of issues that has been of concern to both the Congress and the Administration is that of salaries, benefits, and administrative costs within the multilateral development banks. Of these issues, the predominant one has been staff salaries. With the strong support of the United States, the management of the World Bank and the IMF formed a Joint Committee of Executive Directors on Compensation Issues. This Committee was given responsibility to study the compensation situation of all IMF/IBRD employees and to make appropriate recommendations to the Executive Boards of the two institutions. The Committee met on numerous occasions throughout 1977 and 1978, employed professional compensation girms to obtain necessary data for comparative purposes and finished its work in late December. Its final report has been printed, and copies were sent to the Congress on February first.

This report and its recommendations provide the framework for an objective determination of salaries based on public and private salary levels in member countries.

It advances three basic recommendations:

-- salaries in the main professional grades will be determined as the average of those in the U.S. private sector and the U.S. Civil Service, plus a premium of ten percent. This premium is necessary to adjust for regional differences of pay within the United States and to make the salaries competitive on an international as well as an East Coast basis. Data from the U.S. private sector were used because the costs involved are U.S. costs and the necessary data were available.

-- salaries in the management levels will be determined by setting a moderate differential for each successive grade over the preceeding grade, to arrive at a rational management structure.

-- tax reimbursement paid American staff will be calculated from the net salaries, using the average deduction for that income level, rather than the standard deduction as heretofore.

The net effect of these recommendations would be to bring Bank and Fund salaries more closely into line with comparable public and private sector salaries, as directed in Section 704 of Public Law 95-118. We will be working with other countries to obtain adoption of the new compensation system by the Boards of the Bank and the IMF.

HUMAN RIGHTS

The Administration and the Congress share a firm commitment to a foreign policy which gives high priority to enhancing respect for human rights throughout the world. In December of last year, President Carter vigorously reaffirmed this commitment on the occasion of the 30th anniversary of the Universal Declaration of Human Rights.

Our policy in the banks has been aimed at inducing improvements in specific problem situations. We believe this objective can be achieved by demonstrating to human rights violators that there are costs attached to continued oppressive practices, and conversely by demonstrating that there are benefits to those governments which promote human rights.

In a report submitted to the Congress in October 1978, the Secretary of State and I described in detail how this policy has been implemented in the last 18 months. As that report indicated, we have pursued our human rights policy across the range of our relationships with other countries. In the foreign assistance area, our bilateral program has been governed by this principle and the related concerns of reaching the poor and meeting basic human needs. We define human rights to include, beyond freedom from governmental violations of the person, basic economic and social rights such as adequate food, housing, clothing, health care and the opportunity to play a productive role in society. The banks enhance respect for human rights in the developing world by increasingly shifting the emphasis of their lending programs toward reaching the poor and meeting basic human needs.

We have encouraged the banks in this shift of emphasis to projects which reach the poor and help meet basic human needs, and we usually support projects for those countries with human rights problems if they benefit the poor and meet basic human needs, in order not to penalize the people for the abusive policies of their governments.

We have undertaken consultations with other countries on human rights problems, and we have raised human rights concerns in the banks by opposing, through "no" votes or abstentions, 50 loans to 15 countries where we considered the human rights situations severe.

We have also taken steps to implement Section 611 of the FY 1979 Appropriations Act, which calls on the U.S. Governor to "propose and seek adoption" of a charter amendment in the banks that would establish human rights standards to be taken into account in connection with each loan. In an effort to generate support for such an amendment, and to ensure its best chances for adoption, we have consulted other governments who share our human rights concerns and sought their views and agreement with this proposal.

Thus far, the reactions of other governments to the proposal of an amendment have been negative. They believe the introduction of such amendments would be unnecessarily divisive and that they would not obtain the broad support required for their adoption. In view of such reactions we are undertaking additional consultations to pursue this approach and to achieve the objectives of the legislation.

In light of existing legislation which requires the United States to vote against loans to countries that are found to violate human rights consistently, I see no need for special legislation aimed at restricting multilateral development bank lending to particular countries. In accordance with Section 701(f) of Public Law 95-118 and the Administration's policy, we have voted against or abstained on 50 loans to 15 countries. The present legislation is being implemented conscientiously, and I believe that no change is necessary at this time.

Indeed, as I have stated in the past, contributions made under legislation prohibiting the use of U.S. contributions to the banks for loans to specific countries would have to be rejected by the institutions. Under their charters, the banks cannot accept funds from the United States or from any other member which are restricted on country grounds. Any provision in U.S. law which would prohibit the use of appropriated funds for multilateral development bank lending to selected countries would seriously jeopardize continued U.S. participation in the banks at the expense of our human rights and other foreign policy objectives.

ACCOUNTABILITY

A number of steps have been taken during the past two years to strengthen procedures for accountability of the multilateral development banks and to increase the flow of information on their activities which is available to the Congress and to the public. We are continuing to follow the activities of the banks closely to assure ourselves that audit and evaluation mechanisms within the banks are funcuioning adequately.

Each of the banks is audited by well-known auditing firms. The results of these audits are published in the annual reports. They are also required to file specific financial information with the Securities and Exchange Commission in order to issue bonds in the U.S. capital market. This information is available to the public. In addition, the banks have made available to the public, on a subscription or referral basis, their Monthly Operational Summaries which list all projects under consideration for financing and show

their status, and statements of loans and press releases on each loan which is approved. They also publish many of their country economic reports, research papers related directly or indirectly to their operational lending programs, other occasional papers, and a wide variety of statistical reports on all aspects of their operations. The World Bank makes available to the public its Catalogue of Publications briefly describing its research and occasional papers from which the public may order documents. Similarly, the IDB makes available to the public papers prepared for seminars and roundtable discussions as well as many of their country economic reports. I might also add that information from the loan documents is available on request, after Board consideration, to businessmen and other members of the public.

The Treasury Department routinely transmits to the Congress and the General Accounting Office numerous documents in compliance with various legislative provisions as well as to meet special requests. Included in the documentation which goes to various offices are the Monthly Operational Summaries listing loan proposals under consideration or appraisal in the banks, Statements of Approved Loans for the banks, statements of income and financial condition, status of negotiation notices, brief loan analyses prepared bi-weekly by Treasury Department staff, project evaluation reports, and various sector and policy papers and reports. In addition, the U.S. Executive Directors and members of the Treasury staff are available to talk with Congressional members and staff regardiog any other material they may wish to know about the bank or its activities.

During the past year we have continued to press the banks to review their classification systems and to declassify as many documents as possible. The World Bank has declassified the World Development Report, the Energy Report and its Commodity Price Report. It has also made public project performance audit reports. In the IDB, the Monthly Operational Summaries have been declassified during the past year.

All of the banks now make available to the public Monthly Operational Summaries on the status of future projects. It is now possible for businessmen and

other members of the public to subscribe to these reports on a monthly basis from the World Bank and the Asian Development Bank. In the case of the IDB, the Monthly Operational Summaries are available to businessmen and the public through the U.S. Commerce Department, although we are working with the bank to get it to provide this material directly and on the same basis as the other banks.

With regard to the question of financial controls and reporting requirements, the Articles of Agreement for all of the Banks contain explicit provisions that the Banks shall ensure that the proceeds of any loan are used only for the purpose for which the loan was granted. To carry out this provision, the Banks include a number of requirements either in the loan document itself or in other agreements made with the borrowers. Each borrower is required to have his overall financial position audited by independent outside auditors approved by the Banks. In addition, each project in which the Banks participate is either subject to independent audit or to a requirement that books be kept open to the Banks for inspection.

Each of these banks has an independent operations evaluation unit whose personnel are responsible to management and, in the case of the World Bank and the Inter-American Development Bank, directly to the respective Boards of Executive Directors. In the Inter-American Development Bank, programs are evaluated by a three-member "Group of Controllers" and its staff. This group was established in 1968 and its members are appointed from outside the bank for non-renewable tiree-year terms and report directly to the Bank's Board of Executive Directors.

In the World Bank Group, projects are evaluated by the Operations Evaluation Department. It is headed by a Director-General who reports directly to the Executive Directors. The Operations Evaluation Department uses "Project Completion Reports" and Project Performance Audits to evaluate the impact of the Bank's development projects. In the Asian Development Bank, selective project evaluations are conducted by both the bank's own Economic Department and by independent outside evaluators from various countries. The African Development Fund is currently establishing a system for evaluating projects.

During the past year, the General Accounting Office completed studies of these independent review and evaluation units and made a number of positive findings with regard to their operations and effectiveness.

In the case of the IBRD, the GAO auditors indicated that the World Bank Group has made considerable progress toward developing an independent and continuous selective examination, review, and evaluation of the Bank's programs and activities.

With regard to the IDB, they said that the effectiveness of the Group of Controllers has improved steadily since its creation and that its reports have contained many recommendations for improving Bank operations. They noted that most of the recommendations have been adopted by the Board of Executive Directors and that Bank management has taken specific actions to implement them.

With regard to the ADB, the auditors said that some progress had been made in improving the review and evaluation of projects assisted by Bank financing, but that the expanding volume of Bank lending made more independent and wider-range review and evaluation necessary and desirable. They made several recommendations in each report for improving the systems in the respective banks. These recommendations cover, among other matters, the scope of some of the individual reports and the need for maintaining or strengthening the independence of the evaluation units.

Specific requirements with regard to procurement procedures and the disbursement of funds are set forth in loan agreements with individual borrowers and in operating manuals and instructions of uhe banks. Procurement is either by international competitive bidding, international shopping, or local procurement. All of these procedures must meet detailed bank requirements. Depending on the exact disbursement procedure followed, the borrower is required to present any or several of the following types of supporting evidence for substantiating withdrawals from the loan account: the contract or confirmed purchase order and evidence that the payment has been made, such as suppliers' invoices and bills of lading, consultants' invoices in case of consultancy services, contractors' invoices and borrowers' certificate of work progress

in case of civil works, letters of credit against which the banks' commitments are being sought, and negotiating banks' reports of payment accompanied by suppliers' invoices.

Each borrower is also obliged to meet a number of other reporting requirements. He must keep records relating to the progress of the project and the cost of carrying it out. He must permit Bank representatives to visit the project site, inspect the works being carried out and the records related to it. He must also be prepared to submit to the Bank on request any additional information concerning the progress of the project and his operational and financial conditions.

All of the banks maintain supervision systems to oversee the fulfillment of the established requirements. The IDB has a resident mission in each recipient country which monitors the progress of projects and checks for compliance with provisions of the loan agreement. The World Bank and the ADB do not have representatives in all recipient countries. However, members of the staff visit the borrowers and the project sites, generally once a year, but more often if it is necessary. In addition, staff members at the banks headquarters regularly review procurement documents and the recommendations for bid awards. In the case of credit projects, they review and approve subloans above certain minimal amounts. They also review progress reports submitted by the borrowers for all projects and correspond with them on a wide range of project implementation issues.

We are working to carry out the recommendations of the General Accounting Office/ We are also committed to strengthening the accountability of the banks and to increasing the flow of information on their activities. Complete disclosure of all bank information, however, is neither feasible nor desirable. We have to balance our oversight responsibilities with the confidential nature of the banks relationships with its borrowers, especially concerning economic policy advice which may be sensitive in recipient countries.

COMMODITY LEGISLATION

Following passage of the appropriations legislation last October, procedures have been established to

implement two provisions in the legislation dealing with commodities. The legislation requires that the United States oppose use of MDB funds for the production of any commodity for export if it is in surplus on world markets and if substantial injury would be caused to U.S. producers of the same, similar or competing products. It also provides that the President shall initiate international consultations designed to develop standards governing the allocation of development assistance for production of commodities in surplus on world markets where increased efforts would cause substantial harm to other producers.

As a matter of fact, however, the banks have been making very few loans that could fall under these provisions. To carry out the legislative requirements, we have carefully analyzed these loans to determine the economic impact of production on the world markets. No loan proposals thus far this year have required special action because the commodities to be produced either were for domestic production or would not be in surplus or result in substantial injury to U.S. suppliers.

Essentially, our approach is based on the principle that loans for projects that will result in the increased production of commodities in prospective world surplus will prove to be a wasteful use of development assistance resources. Fortunately, our approach is also followed by the banks in identifying and appraising projects.

With regard to the second provision of the legislation, the United States has raised internationally the issue of allocation of assistance for the increased production of commodities in surplus. We are seeking agreement among the OECD countries on general principles that such an allocation of assistance can be disruptive to producers in developed and developing countries alike, that it may prove counter-productive to bilateral and multilateral development efforts, that international standards should be developed generally to avoid assistance for surplus commodities while taking into account world-wide comparative advantages in commodity production.

There is no need for additional legislation aimed at restricting uses of U.S. funds by the banks for the financing of special commodities on products. As I have noted with regard to country restrictions, the banks could not legally accept contributions on those terms. Any such provision in U.S. law would seriously jeopardize continued U.S. participation in the multilateral development banks.

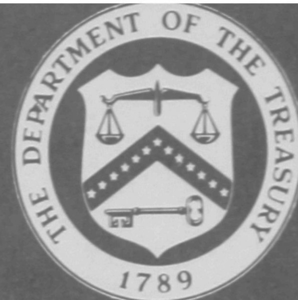
CONCLUSION

In my testimony to this Subcommittee last year, I expressed the hope that Congress and the Administration would work out a consensus or common view of our objectives in the multilateral development banks. I suggested that the consensus might include agreement on our basic goals within the banks such as reaching the poor more directly and effectively, promoting human rights, assuring accountability, and rationalizing administrative costs.

In my testimony today, I have dealt at some length with these matters and with other issues which have been of concern to the Congress and the Administration including promoting use of capital saving technologies and limiting bank financing for production of certain commodities. Over the past year, there has been a record of substantial progress on these issues. We have not been able to prevail in every instance or have every issue resolved exactly as we might have wished. Other countries contribute to the banks and their views have to be taken into account. That is a limitation of the multilateral approach but it has been more than offset by the many advantages we have derived from our participation in these institutions.

I am hopeful, as a result of the progress that has been made over the past year, that Congress and the Administration will agree on providing our share of subscriptions and contributions to the multilatral development banks for FY 1980 and that we can continue to effectively pursue our interests in the banks.

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



FOR RELEASE AT 11:00 A.M.
March 15, 1979

Contact: George G. Ross
202/566-2356

THIRD PROTOCOL TO THE PROPOSED
INCOME TAX TREATY BETWEEN THE
UNITED STATES AND THE UNITED KINGDOM

The Treasury Department today announced the signing in London of a third Protocol to the proposed income tax treaty between the United States and the United Kingdom.

The proposed treaty was approved by the United States Senate on June 27, 1978, subject to a reservation on Article 9(4) which would have restricted the power of states of the United States to apply the "unitary method" of taxation to British enterprises. The proposed tax treaty will not enter into force until it is approved by the United Kingdom House of Commons.

This third Protocol must be approved by both the United States Senate and the United Kingdom House of Commons before coming into effect. It modifies the rules governing U. K. taxation of certain activities carried on by U. S. residents in the United Kingdom sector of the North Sea and provides for special limits to the creditability by U. S. residents of the United Kingdom petroleum revenue tax.

This third Protocol also conforms the language of the proposed tax treaty to reflect the U. S. Senate reservation on Article 9(4) and makes a number of other changes of a technical or clarifying nature to the proposed treaty.

A copy of the third Protocol is attached.

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B-1457

THIRD PROTOCOL
FURTHER 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

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 third Protocol to amend the Convention 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 Protocols signed at London on 26 August 1976 and 31 March 1977 (hereinafter referred to as "the Convention");

Have agreed as follows:

ARTICLE I

(1) Paragraph (2) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(2) The existing taxes to which this Convention shall apply are:

(a) in the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the tax on insurance premiums paid to foreign insurers; but (except as provided in paragraph (6) of Article 10 (Dividends)) excluding the accumulated earnings tax and the personal holding company tax. The foregoing taxes covered are hereinafter referred to as "United States tax";

(b) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom tax"."

(2) Paragraph (3) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(3) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws."

(3) Paragraph (4) of Article 9 (Associated enterprises) shall be deleted and replaced by the following:

"(4) Except as specifically provided in this Article:

(a) where an enterprise doing business in one Contracting State:

(i) is a resident of the other Contracting State; or

(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and

(b) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:

(i) a controlled foreign corporation within the meaning of section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the principle thereof); nor

(ii) created or organised under the laws of the first-mentioned State or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State;

then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, such State shall not take into account the

income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first-mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise."

ARTICLE II

The following new paragraph (6A) shall be added to Article 7 (Business profits) after paragraph (6):

"(6A) The United States tax on insurance premiums paid to foreign insurers shall not be imposed on insurance or reinsurance premiums which are the receipts of a business of insurance carried on by an enterprise of the United Kingdom whether or not that business is carried on through a permanent establishment in the United States."

ARTICLE III

Paragraph (5) of Article 10 (Dividends) shall be deleted and replaced by the following:

"(5) Where a corporation which is a resident of a Contracting State (and not a resident of the other Contracting State) derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the corporation, except insofar as such dividends are paid to a resident of that other State (and where that other State is the United States, to a national of the United States) or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in that other State."

ARTICLE IV

Sub-paragraph (b) of paragraph (1) of Article 19 (Government service) shall be deleted and replaced by the following:

"(b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident and a national of that State."

ARTICLE V

Paragraph (4) of Article 23 (Elimination of double taxation) shall be deleted and replaced by the following:

"(4) Notwithstanding subparagraph (a) of paragraph (1) of this Article, the amount of United Kingdom petroleum revenue tax allowable as a credit against United States tax shall be limited to the amount attributable to United Kingdom source taxable income in the following way, namely:

(a) The amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom to be allowed as a credit for a taxable year shall not exceed the amount, if any, by which the product of the maximum statutory United States tax rate applicable to a corporation for such taxable year and the amount of such income exceeds the amount of other United Kingdom tax on such income.

(b) The lesser of (1) the amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom that is not allowable as a credit under the preceding subparagraph, or (2) two percent of such income for the taxable year shall be deemed to be income taxes paid or accrued in the two preceding or five succeeding taxable years, to the extent not deemed paid or accrued in a prior taxable year, and shall be allowable as a credit in the year in which it is deemed paid or accrued subject to the limitation in subparagraph (a) above.

(c) The provisions of subparagraphs (a) and (b) above shall apply separately, *mutatis mutandis* (but with the deletion, in the case of (b), of the words "the lesser of (1)" and "or (2) two percent of such income for the taxable year") to the amount of United Kingdom petroleum revenue tax on income from initial transportation, initial treatment and initial storage

of minerals from oil or gas wells in the United Kingdom."

ARTICLE VI

The following new Article 27A (Offshore activities) shall be inserted after Article 27 (Effect on diplomatic and consular officials and domestic laws):

"ARTICLE 27A

Offshore Activities

(1) Notwithstanding the provisions of Article 5 (Permanent establishment) and Article 14 (Independent personal services), a person who is a resident of a Contracting State and carries on activities in the other Contracting State in connection with the exploration or exploitation of the seabed and sub-soil and their natural resources situated in that other Contracting State shall be deemed to be carrying on in respect of those activities a business in that other Contracting State through a permanent establishment or fixed base situated therein.

(2) The provisions of paragraph (1) shall not apply where the activities are carried on for a period not exceeding 30 days in aggregate in any 12 month period. However, for the purpose of this paragraph, activities carried on by an enterprise related to another enterprise shall be regarded as carried on by the enterprise to which it is related if the activities in question are substantially the same as those carried on by the last-mentioned enterprise.

(3) The provisions of Article 8 (Shipping and air transport) shall not apply to a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers."

ARTICLE VII

The following new paragraph (7) shall be added at the end of Article 28 (Entry into force):

"(7) Notwithstanding any provisions of the respective domestic laws of the Contracting States imposing time limits for applications for relief from tax, an application for relief under the provisions of this Convention shall have effect, and any consequential refunds of tax made, if the application is made to the competent authority concerned within three years of the end of the calendar year in which this Convention enters into force."

ARTICLE VIII

(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 30 days following the date on which the Instruments of Ratification are exchanged and shall thereupon have effect, subject to the provisions of paragraph (3) of this Article, in accordance with Article 28 of the Convention.

(3) Notwithstanding the provisions of Article 28 (Entry into force) of the Convention, the provisions of Article 27A (Offshore activities) of the Convention (as added by Article VI of this Protocol) shall not have effect until the entry into force of this Protocol."

In witness whereof the undersigned, duly authorised thereto by their respective Governments, have signed this third Protocol.

Done in duplicate at London this 15th day of March, 1979.

For the Government of the United Kingdom of Great Britain and Northern Ireland:

Evan Luard
Parliamentary Under Secretary of State for Foreign and Commonwealth Affairs

For the Government of the United States of America:

Robert J. Morris
Minister for Economic/Commercial Affairs

Department of the TREASURY NEWS
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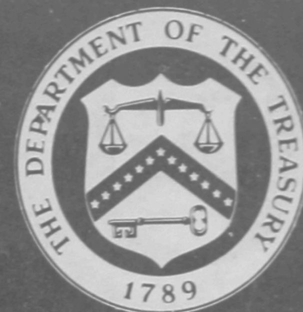

FOR RELEASE AT 4:00 P.M. March 14, 1979

TREASURY TO AUCTION $2,880 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $2,880 million of 2-year notes to refund approximately the same amount of notes maturing March 31, 1979. The $2,879 million of maturing notes are those held by the public, including $743 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

Without assurance, before the auction date of March 21, of Congressional action on legislation to raise the temporary debt ceiling, the Treasury will postpone this auction.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $640 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders. Additional amounts of the new securities may also be issued at the average price to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing securities held by them.

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

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Attachment

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED APRIL 2, 1979

March 14, 1979

Amount Offered:

To the public	$2,880 million

Description of Security:

Term and type of security	2-year notes
Series and CUSIP designation	Series R-1981 (CUSIP No. 912827 JN 3)
Maturity date	March 31, 1981
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 aucti
Interest payment dates	September 30 and March 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, March 21, 1979, by 1:30 p.m., EST
Settlement date (final payment due)	
a) cash or Federal funds	Monday, April 2, 1979
b) check drawn on bank within FRB district where submitted	Thursday, March 29, 1979
c) check drawn on bank outside FRB district where submitted	Wednesday, March 28, 1979
Delivery date for coupon securities.	Monday, April 2, 1979

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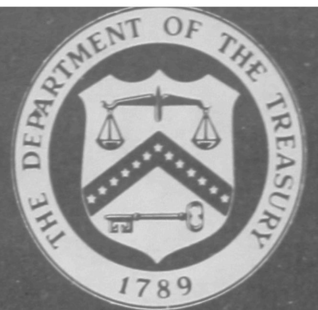

FOR RELEASE AT 4:00 p.m. March 14, 1979

TREASURY WOULD POSTPONE AUCTION
OF TWO YEAR NOTE OFFERING IF CONGRESSIONAL ACTION
TO INCREASE THE DEBT CEILING HAS NOT BEEN ASSURED

The present temporary debt ceiling of $798 billion expires on March 31, 1979, at which time the debt limit will revert to the permanent ceiling of $400 billion. Without new legislation, the Treasury would be unable to assure delivery on April 2 of notes awarded in the auction scheduled for March 21. Therefore, unless there is assurance of Congressional action on legislation to raise the temporary debt limit to allow delivery of the new two year notes, the auction of these notes would have to be postponed.

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B-1459

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FOR IMMEDIATE RELEASE
March 15, 1979

Contact: Alvin M. Hattal
202/566-8381

TREASURY DEPARTMENT ANNOUNCES PRELIMINARY COUNTERVAILING DUTY ACTION ON TOMATO PRODUCTS FROM THE EUROPEAN COMMUNITY

The Treasury today announced its preliminary determination that the Commission of the European Community (EC) is subsidizing exports to the United States of tomato products.

This investigation was begun after a petition was received on August 22, 1978, on behalf of the Canners League of California. A final decision in this case must be made by August 22, 1979.

Treasury's preliminary investigation found the payments made under the EC program of production aid to processors of tomato products to constitute a subsidy.

The Countervailing Duty Law requires the Treasury Department to assess an additional customs duty equal to the net amount of a subsidy paid on imported merchandise.

Notice of this action appears in the Federal Register today.

Imports of tomato products from the EC during 1978 were valued at $8.7 million.

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B-1460

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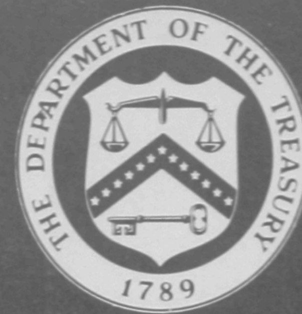

REMARKS BY
THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE
THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
WASHINGTON, D.C.
February 28, 1979 -- 11:45 a.m.

I am delighted to be here with all of you and to have this opportunity to discuss recent developments in the savings bank industry. Since your Washington conference last year, we have all participated in significant developments in your industry and in the financial intermediary markets generally, that have been perhaps unparalleled in recent decades.

A simple listing amply demonstrates the breadth and pace of the changes. Leading the list is, of course, the introduction of the six-month money market certificate. I want to return to this topic later, but for the moment I would only note the observation made last September by the President of your Association who said that the introduction of these certificates represented an historic date for your industry. Saul's judgment in these matters is seldom wrong. Next comes the authorization by the federal bank regulators of automatic transfers from savings to checking accounts. Following that came the Congressional action extending NOW accounts to New York State and eliminating the Regulation Q differential on automatic transfer accounts in the Financial Institutions Regulatory and Interest Rate Control Act of 1978. That same Act, which the Administration supported throughout its tortuous course in the Congress last year, also realized a goal that your industry has long sought--a Federal chartering alternative for savings banks.

B-1461

These are the major legislative and regulatory developments. Your industry is being affected by other forces as well. Inflation continues to plague the economy. Interest rates again hover near historic highs and mortgage rates are pressing against the usury ceilings.

Your industry must confront these changes and challenges in an environment that is quite different from what it was just a few years ago. At one time the principal concern of a savings bank may have been to respond to the demands of such traditional competitors as commercial banks. That world is long since past. To be sure, the introduction of NOW accounts and automatic transfers has intensified the competition between commercial banks and thrift institutions. But the concern of the savings bank industry can no longer merely be with its traditional competitors--no matter how the rules are changing between them. The savings bank industry today must also react to the broader changes in the financial markets which involve challenges and competition from entirely new quarters.

Today your industry competes with credit unions that have come to represent a very important factor in the competition for saving deposits. They may also soon become a significant factor in providing home mortgages. It must also face actual and potential challenges from nondepository institutions that have already begun to tap the deposit markets of banks and thrifts. At the end of last year, money market mutual funds had accumulated assets of $10.8 billion; they have grown by another $3.1 billion since the beginning of this year. Other investment vehicles and services are being offered to the saving public. For example, Merrill Lynch offers a cash management account which permits customers to earn interest on margin accounts, make purchases with a VISA card and write checks against either cash balances or an overdraft line of credit. Also in the wings is a plan reportedly being readied by Sears Roebuck and Company to offer a half-billion dollars worth of $1000 denomination medium-term notes to its 26 million credit card holders. Apparently, AT&T has had a similar issue of its own under consideration for some time.

These developments come at a time when the public itself is expressing renewed dissatisfaction with the

savings vehicles offered by the traditional depository institutions. I think it would be a mistake to view the demands of the Gray Panthers, for example, as an isolated matter. Theirs is a theme that finds support among many of the nation's small savers. The challenge of the small saver is one that depository institutions as a group must meet. If they do not, others probably will.

In this setting, the experience of the thrift industry with the six-month certificates assumes added significance. The experiment initiated last June with the six-month certificates tied to market rates has to date been a success. Reversing the experience in earlier high interest rate periods, the new certificates have effectively stemmed disintermediation from thrift institutions. In general they have allowed housing to become a more effective competitor for money in a tight market and so have contributed to the continuing availability of mortgage credit. At the same time, these certificates have responded to the desires of traditional savers for an instrument more responsive to market conditions. I shouldn't doubt that in the process the money market certificates may have created interest-rate sensitivity among some savers, where it had not existed before.

The figures themselves tell us part of the story. Between June 1 and December 31, 1978, some $12.8 billion moved into these certificates at savings banks. This represented approximately 9.2 percent of the total deposit base of savings banks. The year-end figures for S&L's were higher, with $40.8 billion in certificates, representing 9.7 percent of total deposits. Preliminary figures for January put the certificates at 12 percent of S&L deposits. Looking toward year-end 1979, we have forecasts for these certificates at 15 to 20 percent of savings bank deposits. These forecasts, of course, assume no changes in regulations or law and also depend heavily on interest rate developments.

As I suggested, these figures tell us only part of the story. There are still several questions about the certificates that remain unanswered. One is where the proceeds of these certificates are actually going. Some funds are clearly being invested in high yielding short-term instruments outside the housing sector. But the extent of such non-housing investment is not yet clear from the data.

Another question concerns the percentage of six-month funds that represents new money as opposed to mere shifting of money between types of accounts in an institution. Some industry sources estimate that shifting is responsible for 65 to 75 percent of certificate totals. Some of the regulators apparently would put the figure at closer to 50 percent, by adjusting for funds that would have otherwise left the institution entirely.

The importance of the shifting phenomenon lies in its effect on profits. In the short term, those institutions that are experiencing substantial shifting will find these certificates more costly than those institutions that are able to attract new funds with the certificates. But even for institutions experiencing substantial shifting, it is not clear that these certificates represent a more costly alternative than disintermediation. Moreover, in the longer run, these certificates may contribute to profitability by providing thrift institutions with the funds to make more high yielding mortgages than would otherwise be the case. This earnings prospect would be dampened, however, to the extent that mortgage rates reach the usury ceiling as they have in a number of states.

The regulators are, of course, sensitive to the effects that these certificates may have on the profits and capital position of banks and thrift institutions. For this reason they have been monitoring the development in six-month certificates very carefully. Preliminary analysis indicates that these certificates had a significant but not destabilizing effect on savings bank profits in the second half of 1978. It is obviously too early to make any confident predictions about their effects on profits in 1979. Much will depend on the overall direction of interest rates.

The experiment with six-month certificates provides a perspective on another issue that is sure to command increasing attention in Washington. That is the issue of the overall role of the thrift industry in supplying mortgage credit.

The figures on net acquisitions of residential mortgages for the 1970-1978 period provide some interesting insights into the structure of the mortgage market. S&L's and savings banks were the principal providers of mortgage credit, accounting for more than 50 percent of the $523 billion net growth in residential mortgage credit over the 1970-1978 period.

Commercial banks also became important mortgage lenders, though their contribution tended to vary over the business cycle. Banks accounted for more than 17 percent of the total mortgage growth over the period. In 1970, they accounted for approximately 5 percent of net acquisitions. In 1978, they accounted for more than 20 percent of net acquisitions. Over this period, pools for mortgage-backed securities also grew dramatically, accounting for nearly 15 percent of the growth in residential mortgage credit.

The role of federal programs designed to assist mortgage credit bears special mention. For purposes of this discussion, I am including in the concept of federal support direct residential mortgage acquisition by on-and-off budget federal agencies, FHLB advances to S&L's and increases in mortgage pools net of S&L acquisitions. Again I am looking at the period covering 1970-1978. In 1970 these federal measures accounted for approximately 30 percent of the net increase in residential mortgage credit. In the next two years, this figure dropped to 7 and 9.5 percent, respectively. In 1974, federal support soared to nearly 50 percent of residential mortgage credit growth due in part to the maturation of the sponsored agency programs and mortgage pool activity and in part to the severe disintermediation suffered by depository institutions. Federal support of the mortgage market could be characterized as countercyclical over the 1970-174 period, when credit markets eased and tightened again.

Since 1974, the pattern of federal support has changed considerably. Although the proportion of residential mortgage growth attributable to direct and indirect federal support fell in 1975 and 1976, it did not recede to the 1971-1972 levels of less than 10 percent. Since 1976, the pattern of federal support has continued to account for an increasing proportion of residential mortgage credit growth. By the fourth quarter of 1978, total direct and indirect federal support had grown to more than one-third of the total net increase in residential mortgage credit.

These trends put in perspective the role of the six-month certificates in sustaining the overall mortgage market. Between the first quarter and fourth quarter of 1978, the thrift industry's share of residential mortgage credit growth fell from 54 percent to 44 percent. Over the same period, the federal share rose from 20 to 34 percent.

Regulation Q

We must also look beyond the six-month certificates to the broader question of Regulation Q itself. Public interest in Reg Q has never been greater. Public statements on the issue abound. Indeed, we are even at the point where Reg Q has captured the attention of newspaper cartoonists.

As you know, last year the President established an interagency task force to provide recommendations on the future of Regulation Q. That task force has been at work. We would hope over the next month or so to move toward a set of options for the President. Right now no one can say with much confidence what the final options will look like. As you might suspect, there is substantial disagreement among task force members over some of the issues. But I suppose we might all take a clue from the direction in which financial markets already appear to be moving. The developments in recent years have pointed to a progressive easing on the liability side of the thrift ledger: the removal of the ceilings on CD's of $100,000 or more; the introduction in New England and spread to New York of NOW accounts; the advent of automatic transfers; and, of course, the six-month certificate itself. The thrift industry will continue to feel pressure on the liability side as small savers in particular increase their demands for recognition. All of this places a special premium on achieving changes in the asset powers of the thrift industry to balance the changes occurring on the liability side.

The savings bank industry in particular, has a very substantial stake in ensuring that the asset powers of the thrift industry provide the necessary base to support the changes occurring on the liability side. This is one issue on which your voices must be heard.

Tax Proposals

Let me turn for a moment to some issues that I know are of interest to you and that fall squarely within Treasury's traditional area of concern. These are issues of tax policy and tax reform. I think it might be useful just to recap where we stand today and where we are likely to go in the future. As you know, the Administration's tax package last

year included several proposals that would have directly affected the thrift industry. Of great interest to all was the Administration proposal for a significant adjustment in the bad debt deduction for financial institutions. This proposal did not find substantial support in the Congress last year, and we do not plan to reintroduce it this year.

What then does the present year hold in the way of tax proposals? One of the themes that is already appearing in proposals before the Congress is tax relief for savers and home-buyers. This is not a new theme, but it seems to be receiving some attention again. Although the specifics vary, the proposals generally take two forms. One is a tax credit or deduction for amounts contributed to an individual housing account. The other is a general exclusion from gross income for specified amounts of interest earned on time and savings accounts.

In commenting on these and the other proposals that we will surely see in coming months, there are several considerations we must keep in mind. First is a concern for the saving and capital formation process and for the effects that these proposals may have generally in this important area. Another is a concern for the efficiency and equity of providing subsidies to the housing sector, particularly through tax measures. But outweighing all other considerations in the end is a simple and direct concern for the revenue effects of these proposals.

Because these proposals are directed only at interest earned on accounts at depository institutions, we question whether they will have any substantial effect on the overall capital formation or savings process. Such proposals might merely lead to a shifting of funds out of such sources as federal securities and tax exempt municipal securities into depository institutions. Thus the indirect effect could be to increase the borrowing costs for federal and municipal entities and for other private entities as well. The need for additional capital formation can play little role in justifying these proposals if their primary effect will be merely to redistribute savings within the economy.

These redistributive effects suggest to me that the Reg Q considerations loom larger in these proposals than capital formation considerations. Indeed, I have already seen it suggested that we use these tax proposals to requite the small saver for the limits imposed by Reg Q.

Revenue considerations aside, I think it would be a mistake to rely on tax measures to address the more fundamental questions presented by Reg Q.

Considerations of efficiency and equity also cast some doubt on these proposals. I question, for example, whether the individual housing account will really induce many home purchases that would not otherwise have occurred. We would be adding subsidies to a sector of the economy that already enjoys substantial tax advantages and direct subsidies.

These additional subsidies would come at a very substantial price. Estimated revenue costs for the first four years of operation of an individual housing account like that proposed by Senator Chafee total $6.9 billion. The estimated revenue costs of providing a general exemption for the first $500 of interest earned on time or demand deposits would be at least $3 billion annually. We believe that these are unacceptably high costs to incur in a period of budget austerity when the federal government is exerting a maximum effort to contain the deficit.

That may seem an unduly unsympathetic view of a modest proposal, but we try to be evenhanded in the Treasury. Last year, I am told, we considered at least 87 varieties of suggested tax credits--some as appealing as credits to hire maids, to beautify neighborhoods or to heat swimming pools with solar devices. Many were directed at generally laudable objectives, but if they all had been adopted the economy would have collapsed under extraordinary federal deficits and the integrity of the federal tax system would have been destroyed. Now and then a tax credit is an efficient instrument of public policy, but at Treasury I must admit that the time is seldom now.

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strongly suggest that the importance of our bilateral trade will continue to grow. At the same time, the critical trade issues facing us must be viewed in the broader perspective of the global trading system and of the global economic interests of both countries.

A major factor in this perspective is that the United States is of course the world's largest trading country, with far-reaching responsibilities for promoting the maintenance and further liberalization of the world trading system. Another is that Mexico, to its credit, has over the past two decades clearly emerged as a major participant in the international economic system. It is, in fact, one of a small group of countries we now refer to as Advanced Developing Countries, or ADC's--countries which have achieved intermediate levels of economic development and which clearly have the potential to move into the ranks of major world economic powers.

An indicator of Mexico's growing status is the performance of its exports in this decade. Since 1970, its total exports increased from $1.4 billion to about $6 billion in 1978, an average annual growth rate of 21 percent. Moreover, Mexico enjoys some of the brightest prospects of any country for future expansion of exports and of its domestic economy.

We welcome the enhanced role Mexico is assuming in the global economy. Its new position will lay the groundwork for expanded and productive Mexican relations with the United States

and other countries. We reaffirm that there is room for Mexico, as a result of its dynamic development and outstanding prospects, among the major industrial and trading nations of the world. Mexico is, of course, considering how it can most effectively translate its augmented position in the world economy into the greatest possible benefits for its own economic development. In the trade area, it is now assessing whether to take two important steps to improve its prospects -- membership in the General Agreements on Tariffs and Trade, and full participation in the pending conclusion of the Multilateral Trade Negotiations in Geneva. Mexico has decided to initiate negotiations for possible accession to the GATT, and is participating fully in the MTN negotiations. If Mexico is to play its rightful role in the global trading system, and if we are to assure maximum cooperation between the United States and Mexico in the trade area in the years ahead, Mexican GATT accession and full Mexican participation in important MTN agreements, such as the code on subsidies and countervailing duties, could make an important contribution.

U.S.-Mexican Trade

Bilateral trade between the United States and Mexico has multiplied in this decade and has assumed greater importance for both countries. In 1977, such trade reached $9.2 billion compared with $2.8 billion in 1971. Mexico is already

the United States' fifth largest trade partner. The United States supplied 60 percent of Mexico's imports in 1977, and took 62 percent of its total exports. Bilateral trade flows could well reach $30-35 billion by the mid-1980's -- a remarkable increase over such a short period of time.

Mexican exports of both manufactured and agricultural goods have figured importantly in the total trade picture. In 1977, fully $2.2 billion of U.S. imports from Mexico (47 percent) were industrial products. An additional billion dollars in imports (21 percent) were agricultural products, an important source of income for Mexico. We expect that both these categories of imports will continue to show sizable increases. We see Mexico as a trading partner of growing stature, a true partner with whom we will develop a full range of trade relations that will strengthen economic growth on both sides of the border.

To be sure, Mexican energy exports to the United States are also likely to grow. As President Carter has emphasized, the development of Mexico's energy resources is a decision which will be made by Mexico based on its own priorities and needs. Our two Presidents had fruitful discussions last month on a range of U.S.-Mexican energy issues. They agreed to continue bilateral talks on a number of these issues, including possible exports of Mexican natural gas to the United States. I am confident that, based on

those discussions, we will now be able to make progress toward an accord which will fulfill important objectives of both countries.

We welcome indications that Mexico is about to embark on an ambitious new industrial development program. We support its goals of encouraging rapid economic growth, decentralizing industrial development, encouraging investment in strategic sectors of the economy, and spurring the development of small industries. Most importantly, the program should greatly increase employment opportunities in Mexico--which is of great interest to the United States.

Such a program will certainly encourage--and, indeed will in part depend on--increased exports, both to the United States and other markets. At the same time, it will stimulate demand for imports, which are likely to come largely from the United States. We welcome the prospects of greater bilateral trade, and remain committed to maintaining the greatest access possible to our market for Mexico. Our success in carrying out this policy thus far can be measured by several indicators:

-- U.S. imports of Mexican manufactured goods more than quadrupled from 1971 to 1977, expanding from $492 million to $2.2 billion;

-- Duty-free imports from Mexico into the United States under the Generalized System of Preferences (GSP) have grown from $253 million in

1976 to $458 million in 1978, a jump of 81 percent in only three years and considerably above the 65 percent increase in all GSP imports over the same period;

-- Mexican imports under sections 806.30 and 807 of the U.S. Tariff Schedules have increased from $270 million in 1971 to $1.15 billion in 1977, with $525 million of the latter accounted for by Mexican value added. These sections provide for reduced payment of duty on articles imported from the United States, assembled or manufactured in Mexico, and re-exported to the United States;

-- Between 1975 and 1977, Mexico's trade deficit with the United States declined from $2.1 billion to $200 million, and our projections indicate that the balance may soon be in Mexico's favor.

The United States has consistently resisted demands for new import restrictions. President Carter in 1978 rejected five recommendations to restrict imports, while the relief granted in three other cases affected an insignificant amount of trade with Mexico -- only about $1.5 million. We intend to continue this policy to benefit Mexico, as well as other developing countries, as much as possible through access to our markets.

In the MTN, for example, we have offered to cut tariffs on a wide range of products of interest to Mexico.

Potential Problems

The increase envisaged in U.S.-Mexican trade, however, is not without some risk. We have maintained our record of openness to imports despite strong domestic pressures to place limits on them. Those products which Mexico is most able to export to the United States, including certain agricultural goods and labor-intensive manufactured goods, are often the subject of proposals for restrictions in the United States.

Increasingly, the ability of the United States--and other industrial countries--to maintain its commitment to trade liberalization depends critically on the willingness of other countries in turn to open their markets to imports and to avoid subsidies on their exports. Clearly, it is in the interest of Mexico and other ADCs to help maintain the momentum of liberalization from which they have so greatly benefited.

In the past, Mexico has discouraged imports by means of a complex system of import licensing. We are encouraged by Mexico's recent shift in emphasis from licensing requirements to tariffs. Since it began to reduce its licensing requirements, Mexico has removed over 5,000 categories, or nearly 70 percent of the total, from the import permit list. We applaud these initiatives and hope that Mexico may soon begin to reduce

its sizable tariffs and eliminate other restrictive requirements as well. We believe that such steps would indeed abet the country's future economic development.

The GATT

The importance of these issues suggests strongly that it would be beneficial for a nascent industrial power like Mexico to assume membership in the body which regulates and fosters world trade--the GATT. Over 80 countries, including virtually all the world's important trading nations, are members. Several more have expressed their intention to join. We would welcome Mexican membership in the GATT and believe it would further U.S.-Mexican trade relations.

The GATT system has permitted rapid expansion in world trade since its inception over 30 years ago. The management of our bilateral trade problems, and assurance of Mexican access to world markets, can be achieved most effectively through the GATT framework. We see a number of marked advantages for Mexico in GATT membership:

-- Mexico's access to foreign markets will enjoy a much greater degree of security. Mexico already enjoys substantial security in the U.S. market. But if it is to diversify its exports and its markets, Mexico needs assurances of security of access on a multilateral basis;

-- Mexico would have access to the dispute-settlement procedures of GATT in case of disagreements. If necessary, impartial multilateral panels can be called upon to settle differences. Such multilateral review can entail greater objectivity and flexibility, as well as greater bargaining leverage, than may be available bilaterally;

-- Mexico would be in a position to be a strong advocate of its own interests--and the interests of developing countries generally--in GATT deliberations concerning future international trading rules; and

-- Mexico will stand to gain much more from the MTN if it joins the GATT. Other nations will be able to make greater concessions to Mexico if they have assurances that Mexico will participate in and contribute to the global trading system.

GATT membership plainly would benefit Mexico. As one of the leading trading countries of the world, Mexico's participation in the major world trading organization would also enable it to play a leadership role in trade policy among, and on behalf of, developing countries as a group.

To be sure, GATT membership will entail Mexico's assumption of greater responsibilities and obligations. Fears that membership will place intolerable burdens on Mexico, however, or

that it will interfere with Mexico's industrial development plans, would seem to be unfounded:

-- Accession to the GATT is achieved through negotiations between the acceding country and GATT members. The acceding country thus can freely negotiate a gradual schedule of increasing obligations, and need not bind itself immediately to any international obligations it will not or cannot undertake;

-- GATT Article XVIII provides special provisions for developing countries to ensure that they can protect their developing infant industries. These provisions have been strengthened in the current MTN negotiations;

-- The GATT contains special provisions permitting developing countries to exercise safeguards for balance of payments reasons. These rules too have been improved in the MTN;

-- The presence of dozens of developing countries already in the GATT, many of which have experienced dynamic export growth and have been fully able to pursue trade policies which fostered their development, represents empirical evidence that membership does not place intolerable burdens on developing countries; and, finally,

-- While developing countries are expected to contribute to trade liberalization in the MTN, these contributions are freely negotiated and are to be consistent with each country's development, trade, and financial needs. The reciprocity which industrial countries are according each other is neither expected nor sought from developing countries.

The case thus seems clear. Mexico's world role points to its membership in GATT. Other countries would welcome it. Mexico's own interests would seem to require it. We hope Mexico will choose this course in the near future.

The MTN Subsidy Code

Full Mexican participation in the MTN package about to be concluded in Geneva is also important. Mexico has taken an energetic role in MTN discussions, including thorough talks with the United States on tariff reductions. We think that Mexico acted wisely in choosing to work actively in the MTN, and that it should be recognized for its readiness to engage in extensive MTN discussions.

We believe these talks have been useful to clarify differences in perspective and lay the groundwork for ultimate agreement. But time is short -- the United States is now wrapping up its negotiations, and the Administration intends to present a final MTN package to Congress in April. As our two Presidents

agreed, it is therefore essential that the United States and Mexico rapidly conclude a tariff agreement. We have offered substantial cuts which will benefit Mexico. We hope Mexico will join in the MTN efforts to liberalize trade by making contribution consistent with its development level.

One of the most important components of the MTN is a code regulating the use of subsidies and countervailing duties (CVDs). Mexican participation in the code is of great significance to ensure the smooth future development of U.S.-Mexican trade relations. We believe that Mexico has much to gain by participating in the subsidies code:

-- Mexican exports to the United States that benefit from subsidies would be protected from the threat of automatic countervailing duties. For countries which assume obligations under the code, such products could not be subjected to CVDs unless injury is demonstrated--but no such test will apply for countries which stay outside the code.

-- Mexican participation would help encourage the widest possible participation in the code. With such broad participation, exporting countries will have greater assurances that their exports will not have to compete in third markets with products subsidized by other countries -- an important consideration for Mexico, which

subsidizes much less than some of its competitors among the developing countries.

The United States is prepared to make an important contribution to the subsidies code--the Administration has recommended to Congress that an injury test be incorporated in U.S. law. But it should be noted that nations which do not accept the obligations of the code, whether industrial or developing, will not receive its benefits. In particular, the United States cannot apply the injury test to subsidized exports from those nations that fail to sign the code and assume appropriate obligations. In the absence of such obligations, we would continue our current practice of imposing countervailing duties against subsidized imports without an injury finding.

The Code does not seek to eliminate subsidies entirely; rather, its aim is to set guidelines for the use of subsidies which adversely impact on international trade. Developing countries which join the code can fulfill the general obligation to refrain from the use of industrial and mineral export subsidies by assuming obligations regarding the use of these subsidies commensurate with their competitive needs. This provision specifically recognizes that export subsidies are an integral part of many development programs. We realize, for example, that Mexico wishes to adopt certain domestic subsidies to spur development.

But the code also recognizes that subsidies become less necessary as nations develop. This provision is designed to encourage the phase-out of export subsidies as nations become more advanced, and hence have less need for such practices. Nations which accept these responsibilities under the code receive an assurance that, as their subsidies are phased out, their exports will not be countervailed unless injury is shown.

One major ADC has already undertaken such a phase-out commitment and begun to implement it. We hope and expect that Mexico and other advanced developing countries will undertake similar commitments--tailored, of course, to their own development situations.

We do not believe that Mexican obligations under the subsidy code would impair its ability to carry out its development program. Mexico has not relied heavily on export subsidies in the past, although its industry programs may occasionally include such provisions. Mexico's recently announced subsidies too are aimed largely at domestic production, not exports.

In any event, the cardinal point holds -- Mexican sales to the United States, and to all of its major markets, will be better protected with Mexico inside the code rather than outside it. Useful discussions on this issue have already been held on a technical level. We believe that the time is now ripe to bring these talks to fruition in the form of arrangements for Mexican accession to the subsidy code.

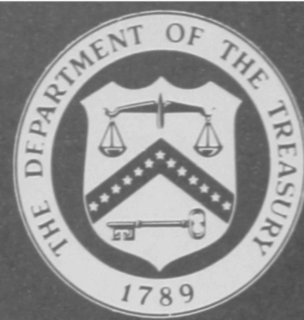
Potential Cooperation for the Future

Mexico clearly has developed into one of the world's most dynamic and influential developing economies. We welcome Mexico's enhanced status and believe that it offers a firm basis to strengthen overall U.S.-Mexican relations.

At the same time, Mexico has an important role to play in the international economy and a vital interest in the evolution of world trade relations over the next decade. In order to protect its interests, and to assume its rightful role in the global trading system, Mexico deserves to have an effective voice in the management of these relations. Active and constructive participation in the GATT and the Subsidy/CVD Code offers a unique opportunity for it to do so.

Both our countries are anxious to obtain the greatest possible benefits from bilateral trade. We know that this is not an easy task. It implies increased commitments and responsibilities. It means greater discipline in the conduct of trade policy. But we firmly believe that the benefits of a more open and flexible world trading system greatly outweigh these considerations. It is our sincere hope that we can work together to help pave the way for greater international trade cooperation and progress in the future.

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



FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
MARCH 19, 1979

STATEMENT OF THE HONORABLE ROBERT H. MUNDHEIM
GENERAL COUNSEL OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TRADE
SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Trade Subcommittee:

I am appearing this morning in support of the Administration's request that the Congress extend for a brief period the authority of the Secretary of the Treasury to waive temporarily the imposition of countervailing duties in selected cases.

The authority to waive countervailing duties was included in the Trade Act of 1974 so that during the 4-year period following its enactment, the Administration would be able to conduct talks with our trading partners in an atmosphere conducive to reaching agreement on an international regime to regulate the use of subsidies.

Governmental subsidies to domestic industries are an increasingly important phenomenon. As Congress recognized, the best hope for preventing such subsidies from distorting trade patterns lies in international agreement. Ambassador Strauss has brought us close to successful conclusion of this difficult task.

Unfortunately, it was not possible to conclude the negotiations among a great many participants within the 4 years originally foreseen by the Trade Act. Thus, the bill before you has the very limited purpose of extending the waiver authority for the brief period during which the negotiations will be concluded. It does not commit you in any way to the substance of the MTN negotiations.

You and your colleagues in the House and Senate will have a full opportunity to review what has been negotiated. In other words, the bill is intended simply to preserve the status quo for about 6 months. Doing so helps make possible the conclusion of agreements which will significantly benefit the United States.

When the waiver expired on January 2, orders that we had published in December suspended final liquidation of imports of the merchandise affected and required importers to deposit estimated duties, provide bonds to cover those duties, or post equivalent irrevocable letters of credit. The specific steps taken are in the discretion of the District Director of Customs. Thus, if the waiver is not extended, the revenue will be fully protected. However, if, as contemplated in this bill, the waiver authority is extended, there will be no problem in making that extension retroactive.

There are presently 15 waivers in effect. Attached to my testimony is a chart showing all of the waivers granted under the law, the subsidy initially found and any amount remaining at this time. As you will see, in some cases, such as those involving Mexican steel, Brazilian handbags, and all the Uruguayan products there has been a complete elimination of the subsidy so that a revocation of the initial countervailing duty order was or is now appropriate. In the other cases, the bill would extend the waivers retroactively to January 3.

In addition, the bill would grant the Treasury authority to waive countervailing duties during the remaining pendency of the negotiations and congressional consideration of the MTN package. In two cases decided before the expiration of our waiver authority -- concerning textiles from Brazil and fish from Canada -- we indicated that a waiver would be granted if such authority existed at the time that the ITC has completed its consideration of the case. The ITC has determined that there is no injury with respect to the Brazilian textile imports. There may also be cases in which the subsidizing country may agree to significant reductions of its subsidy practices and is playing a significant role in the MTN negotiations so that a waiver might be appropriate. However, we anticipate that throughout the

remaining life of the waiver authority, we would exercise the waiver authority pursuant to the same terms and conditions as this Administration has applied to the waivers granted -- subject, always, of course, to congressional reporting and review. That course should assure us and our trading partners that the remaining months of the negotiations are not troubled by what may be regarded by some as a needlessly provacative or unfriendly act.

Finally, we will continue to review the waivers that are now outstanding. The current bill contemplates that we would revoke any waiver where changes in conditions under which it was granted warrant such action. We have taken such action in the past and would do so in appropriate circumstances in the future.

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

FOR IMMEDIATE RELEASE March 19, 1979

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $2,901 million of 13-week Treasury bills and for $3,002 million of 26-week Treasury bills, both series to be issued on March 22, 1979, 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 21, 1979			26-week bills maturing September 20, 1979		
	Price	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/
High	97.609	9.459%	9.85%	95.213	9.469%	10.11%
Low	97.594	9.518%	9.92%	95.205	9.485%	10.13%
Average	97.599	9.498%	9.89%	95.206	9.483%	10.13%

Tenders at the low price for the 13-week bills were allotted 74%.
Tenders at the low price for the 26-week bills were allotted 36%.

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

Location	Received	Accepted	Received	Accepted
Boston	$ 28,955,000	$ 28,955,000	$ 17,140,000	$ 17,140,000
New York	4,412,790,000	2,512,890,000	5,112,290,000	2,807,820,000
Philadelphia	21,565,000	21,565,000	7,045,000	7,045,000
Cleveland	32,385,000	27,385,000	17,170,000	14,170,000
Richmond	22,105,000	22,105,000	11,780,000	11,780,000
Atlanta	31,030,000	31,030,000	20,470,000	20,470,000
Chicago	294,740,000	102,140,000	322,005,000	23,805,000
St. Louis	45,760,000	23,260,000	38,150,000	10,150,000
Minneapolis	4,600,000	4,600,000	2,975,000	2,975,000
Kansas City	27,390,000	27,390,000	23,280,000	23,280,000
Dallas	12,830,000	12,830,000	5,040,000	5,040,000
San Francisco	184,305,000	74,305,000	295,660,000	45,660,000
Treasury	12,435,000	12,435,000	12,325,000	12,325,000
TOTALS	$5,130,890,000	$2,900,890,000a/	$5,885,330,000	$3,001,660,000b/

a/Includes $378,740,000 noncompetitive tenders from the public.
b/Includes $221,970,000 noncompetitive tenders from the public.
1/Equivalent coupon-issue yield.

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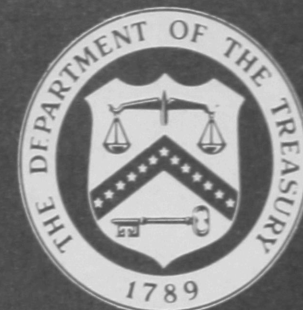

FOR IMMEDIATE RELEASE
March 19, 1979

Contact: Del Dobbins
202/566-5158

FRANK GREATHOUSE AND WILLIAM HENDERSON RECEIVE 1978 JOINT FINANCIAL MANAGEMENT IMPROVEMENT PROGRAM AWARDS

Treasury Under Secretary Bette B. Anderson today presented the 1978 Financial Management Improvement Awards to Frank Greathouse, Assistant to the Comptroller of the Treasury of the State of Tennessee and Director of State and Municipal Audit, and William Henderson, Fiscal Affairs Specialist, U. S. Department of the Treasury. They were recognized for their outstanding contributions to the improvement of financial management in the public sector at the Eighth Annual Financial Management Conference of the Joint Financial Management Improvement Program (JFMIP) in Washington.

JFMIP is a joint and cooperative undertaking of the Department of the Treasury, the Office of Management and Budget, the General Accounting Office, and the Office of Personnel Management to improve financial management practices throughout the Government.

Frank Greathouse was commended for his outstanding leadership and accomplishments in intergovernmental cooperation and coordination of audit efforts for federally assisted programs. He was also recognized for his continued leadership in improving financial management in Tennessee.

Mr. Greathouse has worked with both the National and Southeastern Intergovernmental Audit Forums to enhance coordination of audit efforts among Federal, State, and local governments and to improve auditing of federally assisted programs. He also successfully directed a project to develop a uniform financial and compliance audit guide for auditing organizations that receive multiple grants from many agencies at various levels of government. The guide will provide a means to implement the "single audit" concept for these organizations, thereby eliminating the need for each grant-making agency to perform a separate audit of its own programs.

Under his direction, the Division of State and Municipal Audit has expanded its operational scope to include auditing of federally assisted programs, monitoring independent public accountants' audit of federally assisted programs, and conducting operational and management audits.

In addition, through his efforts, uniform State-wide accounting manuals were prepared for municipalities in Tennessee, and audit standards were developed for auditing municipal governments.

William Henderson was commended for his professional excellence in improving cash management in the Federal Government. As the Treasury respresentative on the President's Reorganization Project to review cash management policies and practices throughout the Federal Government, Mr. Henderson was cited for excellence in conducting and coordinating sophisticated financial analyses to reduce Federal borrowing requirements and related interest costs. He also demonstrated outstanding leadership and technical expertise in representing the project to senior Government officials and preparing reports for the President.

Mr. Henderson led the cash management reviews in the Internal Revenue Service, the Bureau of Alcohol, Tobacco and Firearms, and the Customs Service of the Department of the Treasury. He developed creative and practical ways to strengthen Federal cash management by accelerating the collection of duties and the deposit of accompanying receipts, and accelerating the flow of tax revenues by selectively reducing tax deferral periods. His recommendations are expected to save the Government millions of dollars annually and reduce unnecessary and inflationary Governmental requirements for small businesses.

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